BUSINESS LAW

Third Edition

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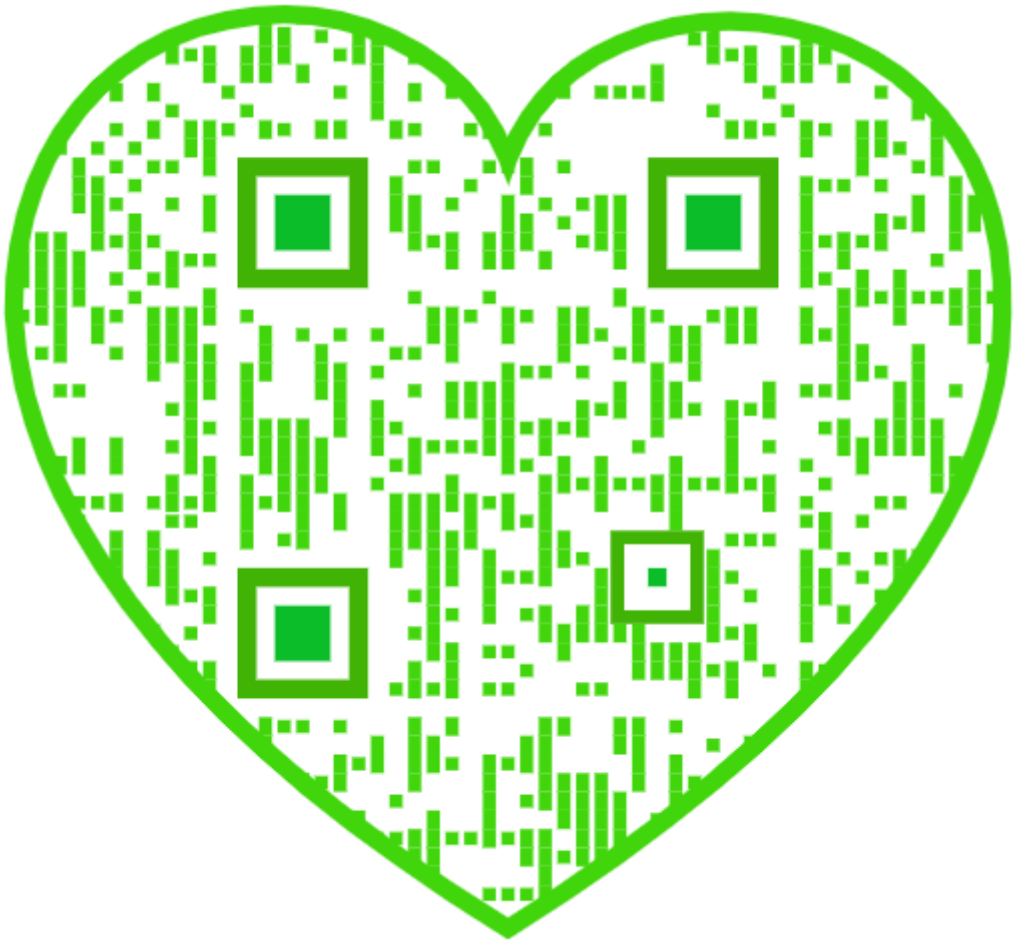

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PREFACE

THE subject of business law, as an important part of a training for commerce and business, must in the main be confined to rules, standards, and principles of law that are more or less stabilized. The long-range view of the commerce and business program clearly emphasizes the necessity of such a limitation. The legal materials that the student masters must not only aid him presently, but also assist him subsequently when he is engaged in economic activities. Therefore, that part of the law which is not yet crystallized or is intended to be temporary in nature and purpose should be largely omitted from his course. Otherwise, when the student has future need of such knowledge, he may possibly base his action or conduct upon rules, standards, and principles of law that either do not exist at that time or have been materially altered. Obviously, it would be better to have no knowledge of the law at all than to possess an inaccurate knowledge thereof and a resulting false assurance.

Although a text on business law contains chiefly well-settled rules, standards, and principles, it must nevertheless be regularly revised. This is due to several reasons. Firmly established law must be applied by courts to new situations that constantly arise in the affairs of men. Also, widespread changes in economic and social philosophy, which occur in unusual periods, are reflected during such time in the legal thought and decisions of our courts. Even during normal times occasionally statutes may have such far-reaching implications that some consideration must be given thereto. Aside from these factors, in order to make the presentation of the legal material more effective, it is often necessary to rearrange or to alter the words or phrases of certain sentences or paragraphs. To the same end, it is also desirable, in a textbook of this kind as it is in others, to insert at times new aids to the learning process.

In this edition, throughout the textual material there have been inserted factual situations, holdings, or quotations taken from recent cases, which in each instance are referred to by

name and citation. These insertions illustrate the legal rules, standards, and principles, show different applications thereof, or give a better understanding by an authoritative and different wording thereof. They also give interest and purpose to the material concerned.

An important addition of great interest is in the discussion of the National Labor Relations Act, which has been changed considerably by the Labor Management Relations Act, popularly known as the Taft-Hartley Law. The rights and duties of employees and the rights and duties of employers are separately and clearly set forth. The new controversial provisions with respect to union practices are also noted.

Another important addition to the text is the insertion, at appropriate places, of the names of the states that have enacted statutes of general adoption. This feature enables the student easily to ascertain whether a particular statutory provision under discussion prevails in the jurisdiction in which he is interested.

New review cases, with the names and citations in each instance, have been added to some of the chapters. The cases for review have proved effective in stimulating interest as well as in challenging independent thinking and in testing the student's mastery of the preceding material.

Many of the questions for discussion at the end of each part are different in this edition. Questions that have proved ineffective for some reason, such as ambiguity, are rephrased, omitted, or replaced with new ones.

The textual material has been changed to some extent in many of the chapters. Alterations of this nature are made to clear up any ambiguity that may be discovered, to show new applications of the rules, standards, and principles of law, and to include any new material that will enhance the value of the book.

The use of citations to the Restatements of the law has been continued in this edition because courts are increasingly citing the provisions of these Restatements in their opinions as the bases of their decisions. These Restatements are prepared by the American Law Institute, an organization composed of judges, lawyers, and law teachers. The Institute is

preparing statements of what its members believe is or should be the law of the land. Unless a principle or rule of law has previously been adopted as a precedent in a given state, courts now have a tendency to adopt the provisions of the Restatements as the law governing issues coming before them. References to the Restatements are indicated in the footnotes in this textbook by the abbreviation "R."

The practice of giving citations to uniform laws proposed by the Commissioners on Uniform Laws has been continued also in this edition. The provisions of some of the laws have been adopted in most of the various states, and the provisions of others are continually being adopted in the different jurisdictions.

Also retained in this edition are the citations to the National Reporter System after the citations to state reports wherever possible in order to give the student a better opportunity to examine the cases cited. It is often impossible to find a library with the reports of the cases decided in each state, but the volumes of the National Reporter System may be found in most communities. The National Reporter System consists of sets of volumes known as Atlantic Reporter (cited A.), Pacific Reporter (cited P.), Southern Reporter (cited S.), Southeastern Reporter (cited S. E.), Southwestern Reporter (cited S. W.), Northeastern Reporter (cited N. E.), and Northwestern Reporter (cited N. W.). Each set contains the reports of cases decided in certain groups of states. A set of volumes known as the New York Supplement (cited N. Y. S.) contains the reports of certain lower courts in the state of New York.

Decisions of the lower courts of the United States are found in a set of volumes known as the Federal Reporter (cited F.) and the Federal Supplement (cited F. Supp.). Decisions of the Supreme Court of the United States are found in a set of volumes known as Lawyers' Edition (cited L. Ed.).

The author gratefully acknowledges his indebtedness to the many teachers of *Business Law* who have given suggestions that have been helpful in the preparation of this revision. As usual, the number who have given suggestions on various

subjects is so large as to preclude each being named individually. The author must, however, acknowledge in particular the assistance of Dr. Walter S. Lyerla, Head of Department of Commerce, Kansas State Teachers College, of Pittsburg, who carefully read the entire book while in manuscript form and who gave many excellent suggestions with reference thereto.

D. A. P.

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INTRODUCTION

LAW AND ITS ADMINISTRATION

Part I—General Considerations

Law and Society. Some knowledge of law is necessary to a greater or a lesser extent for all persons. The truth of this statement is obvious, because the life of each member of civilized society must proceed to a large extent in conformity with recognized rules, standards, and principles of social conduct. Indeed, an individual is confronted almost daily with situations that demand legal information for correct action. To illustrate, a person enters into the relation of landlord and tenant when he signs a lease for his shelter. He deals with the relation of principal and agent in making most of his purchases of food and clothing. He enters into the relation of bailor and bailee when he checks his coat and his hat at a theater or a restaurant. He utilizes the relation of carrier and shipper when he sends a Christmas package by express. He enters the relation of employer and employee when he enters the employment of another. In these and many other instances he is engaging in common acts that involve legal rights and duties.

Individuals participating in economic activities particularly have need for a knowledge of law. They must, of course, have a knowledge of the ordinary rules, standards, and principles of social conduct that are necessary to other members of society. They should also possess a knowledge of the rules, standards, and principles of law governing business conduct in general and governing those relations that are frequently utilized by them in the conduct of their businesses.

It does not follow that, just because a person has some knowledge of law, he is qualified or should attempt to act as his own lawyer. Although there are situations in which a person is compelled to act without first consulting an attorney, there are also many instances when the advice of a person skilled in law is indispensable. The study of law does not tend to cause a person to attempt to be his own lawyer. On

the contrary, an understanding of law tends to make a person better aware of situations involving legal consequences and of the importance of obtaining sound legal counsel before entering into important engagements.

Definition. Law, in its legal sense, as distinguished from other uses of the term, means those rules, standards, and principles governing and regulating social conduct which are recognized and enforced in regularly established public tribunals. It operates to regulate the actions of persons or groups in respect to one another and in respect to the entire social group. Its purpose is to accomplish substantial justice to all parties, in view of the interests of the individual members of society and of the interests of the group as a whole.

> Law has been defined as "the body of principles, standards and rules which the courts of a particular state apply in the decisions of controversies brought before them." (Restatement, Conflicts of Laws, Sec. 3)

Separate rules, standards, and principles are known as laws. Such laws may be mandatory, prohibitive, or permissive. A *mandatory law* calls for an affirmative act, as in the case of a law requiring the payment of taxes. A *prohibitive law* requires negative conduct, as in the case of a law prohibiting the carrying of concealed weapons. A *permissive law* is one which neither requires nor forbids action, but allows certain conduct on the part of an individual if he desires to act. A statute which permits a group to incorporate by fulfilling certain requirements is an example of permissive law.

Laws are made effective (1) by requiring damages to be paid for an injury due to disobedience, (2) by requiring one, in some instances, to complete an obligation he has failed to perform, (3) by preventing disobedience, or (4) by administering some form of punishment. Whether law accomplishes its purpose depends largely, if not entirely, upon the means employed to obtain conformity to its dictates of social conduct and the effectiveness of their administration.

Classification. The great body of rules, standards, and principles which has been formulated for the control of social conduct may be classified in several ways. It may be divided in

terms of the parties involved, its form, its nature, or the relations involved.

Parties. Law, in terms of the parties involved, is divided into public law and private law. *Public law* is that which deals with the relation between the government or state and the individual or the group. This part of the law governs, in general, questions involving the conflicting interests of the individual or the group as against the interests of the community as a whole. In this class are those fundamental principles upon which a state is organized and which outline its functions and define its powers. This body of principles is known as *constitutional law.* Public law also includes a body of rules, standards, and principles known as *administrative law.* This branch of public law is concerned with questions involved in the relations between the individual members and the state in the exercise of the functions of government. There is a tendency, however, to confine the meaning of administrative law to the rules and the orders of commissions and bureaus. Finally, public law embraces rules, standards, and principles which pertain to the protection of society against acts that are inherently antisocial or that are opposed to the interests of society because of the particular circumstances. This branch of public law is known as *criminal law.*

> Criminal law is "that branch or division of law which defines crimes, treats of their nature, and provides for their punishment." (Washington v. Dowling, 92 Fla. 601, 109 S. 588)

The part of the law that deals with the relation of an individual or a group to another member or group in the community is known as *private law.* It embraces the rules which protect personal relationships and personal interests. It deals also with the protection of those interests which an individual or group may possess in things, tangible or intangible. Finally, this part of the law is concerned with the enforcement of duties arising out of and corresponding to the rights pertaining to personal relationships, personal interests, or property, and, also, with the enforcement of obligations arising out of contract.

Form. Law may be classified in terms of its form, as enacted law and unenacted law. *Enacted law* includes all rules, standards, and principles governing social conduct which have been formally and expressly prescribed by the authorized agencies of the people. Under this classification are constitutions, treaties, statutes, and ordinances. *Unenacted law* embraces those rules, standards, and principles which are announced by courts and are based upon the habits and customs of the people.

Enacted law is commonly called the *written law*, and unenacted law, the *unwritten law*. These terms, however, are confusing, because the latter when published are in a sense written law.

> "The so-called 'unwritten law,' by which is meant the private right to avenge a criminal wrong . . . , does not exist at common law, nor does any statute of this state recognize it in any way whatever." (Wehenkel v. State, 116 Nebr. 493, 218 N. W. 137)

Nature. Law may be divided in terms of its nature, as substantive law and adjective law. That part of the law which deals with the rights and duties of an individual or a group is known as the *substantive law*. These rules indicate the extent to which society recognizes rights and duties on the part of its members, and thereby define and limit the acts of one party in respect to another. It is with this portion of the law that we are primarily concerned here.

The law is not complete, however, with the establishment of certain rights and duties. If it is to be effective, it must in part consist of procedural rules by which one may enforce such rights and duties. That part of the law which governs these processes is called the *adjective law*. Although the student of business is not primarily interested in this branch of the law, it is desirable to possess an appreciation of the procedure in general for the enforcement of rights and duties.

Relations. Law may be classified into numerous parts in terms of the relations involved, such as the law of vendor and vendee, the law of insurer and insured, and the law of shipper and carrier. The law of these relations may be arranged so as to be classified in terms of functions of business, as the

law of marketing. In this text the law is divided in terms of the relations involved, but the chapters are so arranged that the subject may be studied from the functional point of view.

Systems of Law. The different organized groups of the world have at different times developed various systems of law. Today there are two chief systems of law which prevail in the Western World; namely, the Roman or civil law and the English or common law. The former system, known as the *Roman law*, the *Roman civil law*, or, more commonly, the *civil law*, originating in Rome, extended with the success of the armies and became the law of the Roman Empire. The body of rules and doctrines of this system, in the main, consists of the compilations of Justinian and his successors. This outstanding lawmaker and the succeeding Roman rulers digested, simplified, and codified the great mass of rules, opinions, and commentaries, which had developed in the administration of the great empire. These compilations are collectively known as the *corpus juris civilis*.

The civil law later became the law of modern continental Europe, being adopted and absorbed during a period extending from the twelfth to the eighteenth centuries. This system of law also prevails at present in Scotland and in all of the Americas, except Canada and the United States. It also furnishes the basis of the law in a small part of the latter countries. In Canada, for example, the civil law prevails in Quebec.

The term *civil law*, besides describing a system of law as distinguished from the common law or other systems, has several other more restricted meanings. It is used to mean a municipal law, which is a rule governing the actions of the inhabitants of a city or state, as opposed to other law, such as international law. Civil law is also used, in contradistinction to criminal law, to mean that part of the municipal law which establishes and enforces civil rights.

The second great system of law, known as the *English law*, the *English common law*, or, more frequently, as the *common law*, consists of the rules, standards, and principles developed in the administration of justice in England from the thirteenth century. It has spread to other parts of the

world and, except in a very few instances, exists wherever English is spoken.

The colonists brought the English system of law to this country. It was later adopted by the original thirteen states and, except one, by the other states entering the union. Thus, it was stated in respect to the law of California: "The act of 1850 adopts the common law of England: not the civil law; not the *jus commune antiquum*, or Roman 'law of nature' of some of the civil-law commentators nor the Mexican law; nor any hybrid system." [1] Although a few of the states along the southern border show traces of Spanish influence, Louisiana is the only state which does not retain the common law of England as a basis of its law. This state was a part of the territory ceded to this country by France, and it retained the civil law in effect at the time the grant was made.

The term *common law* also has meanings other than that of a system of law in contrast to the civil law. It is used, in contradistinction to the rules and principles developed and recognized in courts of equity, to mean the rules based on the habits and customs of the community as announced by courts of law. In another sense it is used in opposition to the rules and regulations established by legislation or, in other words, statutory law, to mean the rules formulated by decisions of courts. The term is also used to indicate the older rules announced by the courts, as distinguished from the newly developed principles established by the decisions of modern courts.

Supreme Law of the Land. In the United States, laws, whether established by state constitutions, legislation, or judicial decision, are subordinate to the Federal Constitution; if they are not in accordance with it, they are inoperative. The highest law of the land, in a legal sense, is (1) the Constitution itself, (2) treaties made by the Federal Government, and (3) Federal laws enacted under authority of the Constitution.[2] To this proposition the peoples of the several states are pledged. It is embodied in the terms of the Constitution,

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[1] *Lux* v. *Haggins*, 69 Calif. 255, 4 P. 919.

[2] The constitution of each state represents the supreme law of that particular state.

which is an agreement in written form to which all of the states have assented.

> "This Constitution, and the laws of the United States which shall be made in pursuance thereof, and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding." (Constitution of the United States, Art. VI)

The Constitution not only prohibits certain actions by the state or Federal governments, but also prescribes certain guaranties to the individual members of society. If any law, whether Federal or state, contravenes such provisions, it is ineffective. In case of a conflict between a state law and the law of the United States, the latter prevails. For example, when Congress enacts legislation pursuant to its express powers, as in the case of interstate commerce, which conflicts with state legislation in respect to the same subject matter, the latter must give way.[3] This is true, however, only when the Federal laws are in pursuance with the provisions of the Constitution. So, also, when Congress has made a treaty with a foreign power, its terms supersede the laws of any state which are in conflict. Such conflict sometimes occurs when the treaty is in respect to the right of an alien to acquire and hold land in this country.

QUESTIONS

1. An editorial in a school paper contains a statement that law is the only form of social control. Some students are discussing the editorial. One maintains that the statement is untrue. The others agree with him and declare that many forms of social control are more effective than law. Do you agree with these students?

2. Virginia M. Johnson, widow of J. P. Johnson, brought suit against Daniel W. Detrich and others. The purpose of the suit was to obtain a partition of certain land situated in the state of Missouri. In an opinion dismissing the suit, the court declared that "law is a rule of conduct." Do you agree with this statement?

3. Bernier maintains that rules of conduct should be established in view of the interests of the individual members of society alone. Is his contention sound?

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[3] *Second Employers' Liability Cases*, 223 U. S. 1, 56 L. Ed. 327.

4. A statute prescribes that "no person shall be allowed to work in a smelter for more than eight hours a day." Is this a mandatory, a permissive, or a prohibitive law?

5. Compton, who is making a "soap box oration" in one of the side streets of a city, declares that all legal rules are made effective by fines and imprisonment. Do you agree with this statement?

6. Mix brought an action to compel the Board of County Commissioners of Nez Perce county to issue a license. In the opinion dismissing the petition, the court declared: "The substantive law is that part which creates, defines, and regulates rights as opposed to adjective or remedial law, which prescribes the method of enforcing or obtaining redress for their invasion." Do you agree with this statement?

7. A motorcycle officer was killed as the result of his motorcycle striking an obstruction located in the center of a street in Galveston, Texas. In an action brought by his widow to recover damages, it was pointed out that the charter of the city exempted the municipality from liability for injuries caused by any defective condition of its streets. Was the charter of the city enacted by the legislature properly designated as private law or as public law?

8. Give the various meanings of the terms *civil law* and *common law.*

9. Clayton is engaged in business in France, and Prescott operates a cattle ranch in Colorado. While on a vacation, they meet at a winter resort. Prescott relates the facts of a controversy arising between him and a neighbor. Clayton states that he had a similar controversy with one of his neighbors in France and that he can advise Prescott of his rights. Should the latter act upon Clayton's advice?

10. McGraw refuses to pay the taxes assessed against his property on the ground that he was not given an opportunity, as required by law, to appear before the board of reviewers for the purpose of objecting to the amount. Is the law to which he refers a part of the criminal law, the administrative law, or the constitutional law?

11. Charles J. Devlin became a voluntary bankrupt. He died during the administration of his estate in bankruptcy. Mary A. J. Devlin, his widow, brought an action against the trustees in bankruptcy to have her interest in the land determined under a state statute instead of under the provisions of the Federal bankruptcy act. The trustees contended that the rights of the widow must be determined according to the terms of the Federal statute. Do you agree with this contention?

12. Cummings maintains that the common law is the supreme law of the United States. Millis denies this, stating that the supreme law in the United States consists of legislation enacted by the states. Do you agree with Cummings or Millis?

Part II—Branches of the Law

Common Law. The common law originated under the Norman kings, although it developed from the Anglo-Saxon law. Before the Conquest, there existed in England a system of law based upon traditions and customs which was limited in scope and existed mainly for the purpose of keeping the peace. The traditional or customary law was enforced in local courts. After the Conquest, these courts continued to enforce the local customs and traditions for slightly more than a hundred years, when they were superseded by the national royal courts.

The Normans established a *curia regis*, or king's court, which functioned where the king and his retinue resided. In the course of time justices were appointed to administer the law, the great court was divided into several divisions, and the people in general were allowed to bring their causes into the king's courts for redress. The decay and disappearance of the local courts which administered the Anglo-Saxon law were partly due to the jury which was one of the outstanding features of the common law. The development of the jury from the *inquest*, a procedure which the Normans brought from Europe for determining facts, caused the people to forsake the local courts and enter the royal courts with their grievances.

Under the Anglo-Saxon system, the rights of the parties were decided by some method, often cruel, which was totally undesigned to establish truth or justice, such as purging by oath or a trial by ordeal. Purging by oath took place when the defendant brought in a prescribed number of persons, called *compurgators*, who would state upon oath that they believed him, thus presumably proving that he was not guilty. In case of a trial by ordeal, the party was tested by some method, as by being thrown into water to see whether he sank or remained above the surface, by having a hand plunged into hot water, or by being made to carry burning hot objects, and his guilt was determined by his ability to resist the effect of the ordeal. These procedures accelerated the adoption of the national royal courts by the people.

The royal justices heard the controversies of the people and determined the cases in accordance with what was presumed to be the general or common law of the kingdom. As there were diverse customs, the procedure probably consisted in announcing what should thereafter be considered the custom of the realm. These decisions were retained as precedents for guidance in determining similar and analogous cases which came before the justices, and in time there existed in fact a body of rules, standards, and principles which represented a common law of the land. These national rules soon superseded the purely local customs and continued to grow to meet the needs of the people under changing conditions. This strong centralized system withstood the spread of Roman or civil law which was adopted by other parts of Europe.

Ecclesiastical Law. It is of historical interest to note that "of the several branches of the unwritten law of England, there is one properly to be deemed common law, yet technically called ecclesiastical law." [1] The latter term refers to that part of the English law which is administered in the ecclesiastical courts. These courts were established after the Norman Conquest, and were given jurisdiction of civil and criminal actions involving clergymen or ecclesiastical matters and of cases pertaining presumably to spiritual matters. In the latter class were marriages and divorces and testamentary causes. Although these ecclesiastical courts still remain in England, they have lost the most important part of their jurisdiction. About the middle of the nineteenth century they were compelled to relinquish jurisdiction over matrimonial and testamentary causes; they now retain only jurisdiction of cases involving or pertaining to the ecclesiastical organization.

Mercantile Law. When England developed into a trading nation, the merchants for several reasons found that the common law was unsuited to their purposes. First, the courts were inaccessible, for in general the merchants and traders were a class roving from one market or fair to another. Second, the procedure of the courts of common law was too slow

[1] *De Witt* v. *De Witt*, 67 Ohio St. 340, 66 N. E. 136.

for the needs of a people desiring an expeditious settlement of a dispute. Third, the common law was ill-adapted to settle their problems and controversies, because it was based upon feudalism. Fourth, the merchants and traders were in many instances foreigners who were unacquainted with the local law. The merchants therefore developed certain rules based upon custom and usages, which had been adopted more or less by the nations in general, to govern merchants' transactions. These rules were known as the *lex mercatoria* or the *law merchant.* They formed a body of law which has been referred to as a "kind of private international law."

> "The law merchant is a system of law that does not rest exclusively on the institutions and local customs of any particular country, but consists of certain principles of equity and usage of trade which general convenience and a common sense of justice have established to regulate the dealings of merchants and mariners in all the commercial countries of the civilized world." (Bank of Conway v. Stary, 51 N. D. 399, 200 N. W. 505)

The law merchant, originating with the traders, had many sources. Many of its rules were taken from the Roman or civil law. Others were influenced by treatises on mercantile law which were written by continental writers. For the most part, however, the body of rules consists of customs and usages of the maritime traders of all nations. In England the development of the law merchant passed through several stages. At first, the rules were for a special class, namely, the merchants and traders, and were enforced in special courts in which they alone could bring actions. Later the mercantile cases were taken into the courts of common law, and the actions were proved by the customs and usages of the merchants. For many years this created an unsatisfactory situation, not only because some of the judges resented and opposed the introduction of these rules into the courts of common law, but also because the judges did not understand the customs and their background. It was not until about the middle of the eighteenth century that these customs were separated and distinguished so as to govern a given set of facts. The law merchant has now been absorbed, in the main, by the common law or crystallized by statutory enactment.

Admiralty Law. This is a system of law which consists of the principles, standards, and rules which have developed in the courts of admiralty. These courts have jurisdiction over all maritime contracts, torts, other offenses, and cases of prize. The jurisdiction of such courts varies in the different countries. In some instances, prize cases or criminal causes may not be included. In England, because of the opposition of the courts of common law and the fact that the maritime law is influenced by customs of other countries, the jurisdiction of the admiralty courts is more restricted than in other countries. In the United States there are no separate admiralty courts. By constitutional provision, admiralty and maritime jurisdiction is given to the Federal courts.[2]

The rules, standards, and principles of admiralty law apply to maritime affairs, such as acts upon the high seas or the navigable waters of a country, seamen's contracts of employment, transportation by water, and other business relating to navigation or transacted at sea. Courts apply the customs, usages, and rules governing navigation and shipping which have been followed generally by the different nations. In some instances these rules have been codified.

Admiralty and maritime jurisdiction depends upon two things; namely, the locality and the subject matter involved. In cases of torts the test of jurisdiction is the locality. If the unlawful act or omission is done upon the high seas or upon navigable waters of the United States, natural or artificial, it is a maritime tort. Examples of such torts are negligence causing injury to passengers, members of the crew, or others; violations of navigation law; and injuries caused by negligent towing, collisions between vessels, or collisions between a vessel and a drawbridge.[3] In case of contracts the test of jurisdiction is in the subject matter. A contract is a maritime contract if the terms thereof involve the chartering of a vessel, its equipment or service, towing, or salvage. In this connection it is immaterial how small or large the craft is, so long as it is being or is capable of being used for transportation upon water.

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[2] *Art. 3, §2.*
[3] *Greenwood* v. *Town of West Port*, 60 F. 560.

Equity or Chancery Law. As England emerged from the simple conditions of a people primarily engaged in agricultural pursuits into a trading nation with a more complicated economic organization of commerce, finance, and manufacture, the common law with its limited remedies and fixed, rigid, and often harsh rules of procedure became inadequate to meet the requirements of justice. Because there was no remedy at common law for a threatened wrong, one was compelled to wait until a wrong had been committed and then to seek redress in damages, even though such damages would not fully compensate one for the injury. Nor was there any provision for compelling one to fulfill his promises, although redress in damages for a failure to perform would be entirely inadequate. Because of these and other defects in the common law, there developed in England a supplementary system of law, called *equity.*

> "The terms 'equity' and 'chancery' are interchangeable and are constantly used as synonyms in all our states, as well as in England." (Wagner v. Armstrong, 93 Ohio St. 443, 113 N. E. 397)

Although equity as a system of law is of ancient origin, this system, as we know it, began with parties seeking redress from the king for wrongs which the common law did not recognize or from which it gave inadequate relief. Because of other matters claiming his attention, the king referred these petitions to his chancellor for settlement. The chancellor, unrestricted by the rules and forms of the common law and being a high churchman, made his decisions in accordance with maxims based on "good conscience" and upon principles borrowed from the civil law. The chancellor saw that in certain cases money damages would not adequately compensate the injured party; hence he exercised a preventive power by enjoining a threatened wrong and, in some cases, by compelling specific performance when an injury caused by a failure to perform could not be redressed in damages.

The decisions of the chancellor were favorably received by the people, and the petitions for relief from wrongs increased until finally the procedure became one of the accepted agencies for the administration of justice. These decisions,

although at first arbitrary, announced principles which became fixed as precedents for guidance in similar and analogous cases, and eventually there was a body of principles, standards, and rules forming a separate and distinct system of law. In course of time the chancellor ceased to be an ecclesiastic, but the principle of equity pleading and practice continued unchanged from its original purpose, namely, to give relief when justice demanded and the law failed to respond. For many years the chancellor administered equity mainly, although not exclusively, in the High Court of Chancery; hence today the courts administering this system of law are known as courts of chancery as well as courts of equity.

The courts of common law bitterly opposed the growing power of the court of equity, but the latter prevailed in the end. The source of equity jurisdiction is primarily the lack of rights or the inadequacy of remedies at common law. It may be concurrent, exclusive, or auxiliary. It is concurrent in cases involving fraud or mistake, and exclusive in cases involving trusts or mortgages. The auxiliary jurisdiction of equity is to aid an action at common law, as by compelling a defendant to declare certain facts or by preserving testimony which is in danger of being lost by the death of a witness before the trial.

Statutory Law. The body of rules, standards, and principles comprising the common law and equity is not stagnant, but is in a state of continual growth. Old established law is skillfully adapted by the courts to meet new situations as they arise in a changing social order. Thus, it is stated that "one of the crowning glories of common law has been its elasticity, and its adaptability to any new condition and new state of facts. It has grown with civilization and kept pace with the march of events so that it is as virile today in our advanced state of civilization as it was when the race was emerging from the dark ages of the past." [4]

It is probably true that the common law and equity law would be sufficient to meet the ends of justice in any society where the affairs of life change slowly. Examples of law being expanded to meet current complex problems are of daily occurrence and are unnoticed by the great mass of the people. On

[4] *Mentzer* v. *Telegraph Co.*, 93 Iowa 752, 62 N. W. 1.

the other hand, where the conditions and state of the social structures change extremely and rapidly, the lag in the law is pronounced and perceptible. In such a case, although the law might eventually overtake the stride of events, it is desirable to enact laws which will give immediate relief to these conditions. Legislation as a means of expressing the law originated for, and during many years was exercised for, this purpose only.

With the passing years, doubts have occurred to many as to the facilities of courts for determining the existing facts in a complex system, and as to the propriety of judges making new laws. In addition there have been great changes in the economic order and in the social theories, such as the great industrial development and the trend of governmental intervention in business. Hence, today at each session of the legislature hundreds of laws are enacted to govern different phases of life. In some instances they merely supplement the common law, whereas in others they modify or abolish the old rules.

In a few states all the laws or the rules of procedure have been reduced to writing in the form of a code. These jurisdictions are called *code states.* There is also a tendency for the states to enact laws having identical provisions, thus giving uniformity to rules of conduct which have hitherto differed frequently and at times widely.

QUESTIONS

1. Burns tells McCall that the chief purpose of the Anglo-Saxon law was to settle fairly the controversies arising among the members of the group. He also states that the law was enforced in a national system of courts. Do you agree with these statements?

2. What were some of the practices under the Anglo-Saxon system to determine the rights of parties?

3. What notable procedure for determining facts was introduced into England by the Normans?

4. When the royal justices began to hear the controversies of the people, did they decide them in accordance with the local rules and customs or in accordance with the general law of the kingdom?

5. Ella S. De Witt brought a suit against her husband, Douglas De Witt, to obtain a divorce and alimony. The suit was brought in the state of Ohio during the twentieth century. Was the case determined by ecclesiastical law?

6. Kimes and Meredith are discussing economic history. The question arises as to the use of the courts of common law by the early English merchants. The former maintains that the common law was well adapted to settle the problems of the merchants. The latter claims that the merchants found the common law unsuited for their purposes. Do you agree with Kimes or Meredith?

7. What were the sources of the rules of the law merchant?

8. How do you account for the fact that the law merchant was not more quickly absorbed by the common law?

9. A. C. Hagen threatened to sell or otherwise to dispose of certain articles of personal property belonging to Mr. and Mrs. George M. Conley. The articles were wedding presents, and the value thereof could not be measured adequately in money damages; hence the loss would cause an irreparable injury. Did the Conleys have a remedy in a court of equity?

10. What is meant by the term *code states*?

11. Edgar McDougal created a trust by will and appointed Anna L. McDougal as trustee. It was subsequently alleged by interested parties that the trustee had negligently failed, after repeated notices, to file complete and proper accounts of her management of the trust estate. Would this controversy properly be determined in a court of equity?

12. How did the king handle the petitions for redress which were made to him by the people?

13. How do you account for the fact that the decisions of the chancellor were favorably received by the people?

14. Kendall, while discussing courts of equity with a friend, declares that the source of equity jurisdiction is the lack of rights at common law. Do you agree with this statement?

15. The state legislatures enact hundreds of laws at each session. Some of the statutes abolish or modify the common-law rules. Does this fact prove that the common law is stagnant or progressive?

16. How is it possible to secure uniformity in the laws of the different states under our present system of federated states?

Part III—Tribunals for Administering Justice

Courts. A court may be defined as a body or tribunal established by the state as an agency with defined powers to meet at certain times and places for the purpose of hearing and deciding matters properly brought before it, and of preventing wrongs, giving redress to the injured, or enforcing punishment against wrongdoers. It consists not only of the judge, but also of all officers necessary for the presentation of controversies or other matters, for the proper recording of the proceedings and official acts, and for the execution of commands duly issued.

Courts are classified as *courts of record* and as *courts not of record.* The former consist of courts whose proceedings are perpetuated by an official record. The findings and judgments of any of these bodies are unimpeachable and can be altered only by that court or by a reviewing court upon the showing of error. A court not of record is an inferior tribunal, having more or less limited judicial powers, whose proceedings are not recorded or, at least, not officially recorded as of absolute accuracy. If there is a record of the proceedings in such courts, the accuracy thereof as well as its existence may be questioned.

> In many states "a justice of the peace is not a court of record." (State v. Allen, 117 Ohio St. 470, 159 N. E. 591)

At common law, courts are classified as *superior* and *inferior* courts. Superior courts consist of courts having general original jurisdiction of certain controversies and possessing supervisory powers over one or more other courts. The fact that the judgment of such a court may be reviewed by another court did not alter its classification as a superior court. The courts under the control of the superior court are known as inferior courts. Today the terms *superior* and *inferior* are at times used to classify courts upon a basis differing from that used at common law. The term *superior court* is sometimes used to indicate the court or group of courts possessing the highest powers; and all other bodies, including the common-law superior court, are classed as inferior courts.

Jurisdiction. A court is empowered to administer justice only in respect to matters properly brought before it. What constitutes matters which may be validly entertained by a particular court, depends upon its jurisdiction. Without jurisdiction of a given controversy, the adjudication of the court is void. *Jurisdiction* may be defined as the authority or power of a court to hear controversies and other matters concerning legal rights and duties, to decide the issues in accordance with the law, and to compel the execution of the judgment rendered.

A court may have original or appellate jurisdiction. In case of the former it has the authority to hear a controversy in its initial stages. A court having appellate jurisdiction, on the other hand, has authority to review a case which has been first determined by an inferior court.

> "'Jurisdiction' of a particular court is that portion of the judicial power which it has been authorized to exercise by the Constitution or by valid statutes." (Morrow v. Corbin, 122 Tex. 553, 62 S. W. [2d] 641)

The jurisdiction of a court may also be general as distinguished from limited and special. A court having general jurisdiction has power to hear and decide all controversies involving legal rights and duties. A court of limited jurisdiction has authority to hear and decide only cases which fall within a particular class. The jurisdiction of a court is special when the court is authorized to hear and decide only certain cases within a class, such as cases in which the amounts involved are below a specified sum, or in which determination is expressly authorized by statute.

> "Justices' courts in this state, both under the Constitution and the justices' code of the state, are courts of limited jurisdictions." (Searl v. Shanks, 9 N. D. 204, 82 N. W. 734)

Courts are frequently classified in accordance with the limit of their jurisdiction. A *criminal* court is one having criminal jurisdiction, or, in other words, one which is established for the trial of cases involving offenses against the public. A *civil* court, on the other hand, is authorized to hear and decide issues involving private rights and duties. In like manner, courts are classified into equity courts, juvenile courts, probate courts, and courts of domestic relations, upon the basis of the limited jurisdiction of the particular tribunal.

Officers of the Court. The term court is sometimes used to mean the judge or judges presiding in a given court. As defined above, however, the term includes other officials who are equally necessary for the proper administration of justice.

The presiding officer of a court is the judge who is publicly appointed or elected for the purpose of controlling the proceedings and of deciding the questions of law that may arise. He has an inherent power to establish certain rules necessary to preserve order or to transact the business of the court. An infraction of these rules or the disobedience of any other lawful order, as well as a willful act contrary to the dignity of the court or tending to pervert or obstruct justice, may be punished as contempt of court. Thus, if one is guilty of acts of violence or of using indecent or insulting language in the presence of the court, he may be fined or imprisoned, or both, by the judge for contempt of court.[1]

> "Disobedience of any lawful judgment, order, or process of the court is a contempt." (Wenger v. Wenger, 200 Minn. 436, 274 N. W. 517)

Attorneys and counselors at law are also officers of the court. They are men who by training and experience become well versed in the rules of social conduct and skilled in the procedure of the administration of justice. They, being selected by the parties to the controversy or in some cases by the judge, are intrusted with the proper presentation of the merits of the issues of a case. Lawyers, whether attorneys or counselors, are required to meet high qualifications as to ability and character, and in return are granted certain privileges by law which, however, may be withdrawn in case of misbehavior or for other good cause.

The clerk of the court performs ministerial duties in general, although a few duties are quasi-judicial. The latter, as a general rule, must be performed under the supervision of the court. The clerk is appointed in some of the higher courts, but he is usually elected to office in the lower courts. His principal duties are to enter cases upon the calendar, to keep an accurate record of the proceedings, to attest the same, and, in some instances, to approve bonds and to compute the amount of costs involved in a given case.

[1] *State* v. *Shepherd*, 177 Mo. 205, 76 S. W. 79.

The sheriff is the chief executive officer of a county. He fills one of the oldest offices known to the common law. "This office is said to have been created by Alfred when he divided England into shires, though Coke claims for it an earlier origin, and says that it existed during the Roman occupation of England, and that Alfred's division into shires or counties was but a more exact description." [2] The sheriff has, in addition to the duty of maintaining peace and order within a given jurisdiction, namely, the territorial limits of a county, many other duties in connection with the administration of justice in courts of record. His principal duties are ministerial and consist of summoning witnesses, taking charge of the jury, preserving order in court, serving writs, carrying out judicial sales, and executing judgments. The marshals of the United States perform these duties in the Federal courts. Likewise, in courts not of record, such as the courts of justices of the peace, these duties, when appropriate, are performed by a constable. Some of the duties of the sheriff are now performed by persons known as court criers, or by deputy sheriffs, known as bailiffs.

The Jury. The jury is a body of citizens duly qualified in a court of justice and sworn to try and determine by verdict the issues of fact submitted to them. The modern jury grew out of the Norman system of inquisition by proof which consisted of discovering twelve witnesses who agreed upon the facts. The testimony of these witnesses, known as *recognitors*, was conclusive as to the rights of the parties. About the end of the fifteenth century the procedure had been changed so that the informed persons merely gave testimony as to what happened, and the facts were decided by a group of uninformed men. A *petit* jury consists of not more than twelve persons, and a *grand* jury consists of not less than twelve nor more than twenty-three persons. There has been some tendency, however, to change by statute the number of members of such groups. Thus, it may be provided that a jury shall consist of six persons in civil or misdemeanor cases in courts inferior to the circuit courts.[3]

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[2] *State* v. *Finn*, 4 Mo. A. 352.
[3] *Postal Telegraph Cable Co.* v. *Patton*, 153 Ky. 187, 154 S. W. 1073.

> "A requisite number of persons having the qualifications of jurors will not constitute a jury, or panel of jurors, unless they are drawn and summoned as jurors in conformity with law." (Dupont v. McAdow, 6 Mont. 226, 9 P. 925)

The first step in forming a jury is to make a *jury list.* This consists of the preparation, by the proper officers or board, of a list of qualified persons from which a jury panel may be drawn later. In the absence of constitutional restrictions, the legislature may specify the qualifications of the persons serving on the jury, such as age, sex, property, character, or residence. The statutes usually give persons in certain classes, such as attorneys, doctors, ministers, firemen, and public officers, the privilege of exemption from jury service.

A certain number of persons are drawn from the jury list, and this group is known as the *jury panel.* The number drawn and the procedure are usually prescribed by statutes. Selection of the jury panel is usually by an impartial means, such as by wheel or from a box. This list is then certified, signed, and delivered to the sheriff. Publication of this list is usually required by statute.

When a jury cannot be secured from the regular panel, because of the absence or disqualification of the members, a court of record has the power to order bystanders, or others having the statutory qualifications, summoned to serve on the jury. These persons are known as *talesmen.* The court also has the power to call a *special venire* when a jury is needed and there is no regular panel present. The method of selecting the special venire is now usually regulated by statutes which prescribe various ways of impartial selection.

Federal Courts. The Federal system of courts consists of the Customs Court, the Court of Customs Appeals, the Court of Claims, the district courts, the circuit courts of appeals, and the Supreme Court.

United States Customs Court. This court, consisting of nine members, was formerly known as the Board of General Appraisers.[4] The duty of the body is to make final decision in

[4] *Mason's U. S. Code, 1926,* Title 19, §405-1.

respect to the law and facts concerning the classification of goods, the rate of duty for each class, and the rules and regulations governing the collection of revenues.

Court of Customs Appeals. This is a court of record, consisting of a chief justice and four judges, which is open at all times for the transaction of business which may be brought before it. The function of this body is to review the decisions of the United States Customs Court upon an appeal made within sixty days thereafter by the collector, secretary of the treasury, or the importer.

Court of Claims. This tribunal is composed of a chief justice and four judges. It has one annual session at Washington which continues until all business is transacted. At the end of each term the clerk gives a report of the judgments to each department head and to other important administrative officers. A report of such judgments is also given to Congress upon the first day of the session. These judgments are payable only upon an appropriation by Congress.

The jurisdiction of this court includes: first, any claim against the United States (except for a pension) founded upon the Constitution or any law of Congress, upon any rule or regulation of an executive officer, and upon any contract with the United States; or any claim for damages in cases, not sounding in tort, which, if the government were suable, could be maintained in any court of law, equity, or admiralty; second, any claim for damages, setoff, or counterclaim which the government may have against the party claiming against the United States; third, any claim of a disbursing officer to relief from responsibility due to loss in the line of duty of papers, records, vouchers, funds, or property in his possession.

In order to facilitate the disposition of cases, the court is "authorized and empowered to appoint seven competent persons, to be known as commissioners, who shall attend the taking of or take evidence in cases that may be assigned to them severally by the court, and make report of the facts in the case to the court." [5]

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[5] *Mason's U. S. Code*, Title 28, §269.

District Courts. The United States, including the District of Columbia, is divided into eighty-five judicial districts. Some states form a single district, whereas others are divided into two or more districts. To illustrate, Arizona constitutes one judicial district, Alabama is divided into three districts, Arkansas forms two districts, and New York constitutes four districts.[6] In each district there is a court having at least one judge, and in some, one or more additional judges.

The district courts have original jurisdiction in practically all cases which may be maintained in the Federal courts. They are the trial courts for criminal as well as civil cases. Illustrations of the latter group which may be brought in these courts are (1) civil suits in law and equity brought by the United States, (2) actions brought by citizens of different states claiming land under grants by different states, (3) proceedings in bankruptcy, (4) civil causes of admiralty and maritime jurisdiction, (5) actions against national banking associations, and (6) cases involving more than $3,000 which arise (a) under the constitution or laws and treaties made thereunder, (b) between citizens of different states, and (c) between citizens of one state and of a foreign state.[7]

Circuit Courts of Appeals. The United States, including the District of Columbia, is divided into eleven judicial circuits, each having a circuit court of appeals. Each of these courts is a court of record. The number of judges in each court at the present time varies from three to seven. The chief justice and associate justices of the Supreme Court are competent to attend the sessions of these courts, and, in case of so doing, they act as the presiding officer. At one time each judge attended the session of the court to which he was assigned, but this practice has been abandoned. Except when disqualified, district judges are allowed to sit with the circuit judges in order to fill the bench. For example, a district judge cannot sit with the circuit judges to hear and determine a case which has been tried before him in the lower court.[8]

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[6] *Ibid.*, §§142-3-4, and 178.
[7] *Mason's U. S. Code*, Title 28, §41.
[8] *Ibid.*, §216.

The United States Emergency Court of Appeals was created in 1942 to hold sessions in Washington, D. C., for hearing petitions for setting aside or enjoining a regulation, order, or price schedule, or for other relief under the Emergency Price Control Act. (United States Code, Supp. V, Title 50, page 1180)

The circuit court of appeals has appellate jurisdiction only and is empowered to review all final decisions of the district courts by means of an appeal or a writ of error, except in cases which may be taken direct to the Supreme Court. The decision of the circuit court is final in almost all criminal cases, in controversies between a citizen of this country and a citizen of another country or between citizens of different states, and in cases involving amounts of not more than $1,000. The same is true in cases arising out of the Bankruptcy Act and other Federal acts such as the Safety Appliance Act, as well as out of the trade-mark, copyright, and patent laws. As a general rule, however, the Supreme Court may of its own initiative order such cases to be transferred to it for review.

Supreme Court. The Supreme Court of the United States is the only Federal court expressly established by the Constitution. All other Federal courts are dependent upon action by Congress which is authorized by the Constitution to create such courts as are deemed necessary. The Supreme Court now consists of a chief justice and eight associate justices. This number, however, may be increased at any time or reduced upon vacancies occurring.

The Supreme Court has original jurisdiction "in all cases affecting ambassadors, other public ministers and consuls, and those in which a state shall be a party." [9] It has appellate jurisdiction in all cases, except as regulated by Congress, which may be brought into the Federal courts in accordance with the terms of the Constitution. It has been noted that in certain cases, unless jurisdiction is assumed by the Supreme Court, the decision of the circuit court of appeals is final. The Supreme Court also has appellate jurisdiction of certain cases which have been decided by the supreme courts of the states. These cases consume by far the greater part of the time of this court. They consist of controversies which involve,

[9] *Constitution*, Art. 3, §2.

first, rights or immunities arising out of the Constitution; or, second, violations of the Constitution, laws, or treaties of the United States by the provisions of the state constitutions or statutes.

State Courts. The systems of courts in the various states are in general organized along similar lines, although differing in details such as the number of courts, their names, and jurisdiction. In some instances there are extreme departures, but it is impossible to give here more than a description of the general scheme in which there is practical uniformity.

Justice Courts.[10] These courts are presided over by justices of the peace. They are ordinarily not courts of record. Their jurisdiction extends usually to the preliminary examination of persons accused of felonies and to the trial of misdemeanors and civil cases involving small amounts. In the civil cases, the jurisdiction of the courts may possibly be extended by agreement. For example, it is sometimes provided that the justice of the peace may decide cases involving amounts less than $100 and, by agreement of the parties, cases involving amounts up to $300.[11] All decisions of the justice courts are reviewable. There is usually a justice of the peace elected in each township, although in some parts of a state, justice courts have been supplanted by city or municipal courts.

County and District Courts.[12] These courts are located in a county or a district composed of two or more counties. They are courts of record and have appellate jurisdiction of cases tried in the justice and police courts, as well as general original jurisdiction of criminal and civil cases. They also have jurisdiction of testamentary and guardianship matters, except when, as in some states, the jurisdiction of such cases has been given to special courts, known as orphan's, surrogate, or probate courts.

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[10] There are also courts in almost all cities, called *police courts*, for the trial of misdemeanors.

[11] *Iowa Code 1927*, §10502.

[12] In a few states there are separate courts of equity. In almost all states, however, suits in equity are tried by the same judge who tries an action at law, but in the former instance he applies the principles of equity to the case. In code states the tendency is to abolish the difference between equity and law procedure.

Intermediate Courts. In some states there are intermediate superior courts which have original jurisdiction in a few cases, but, in the main, appellate jurisdiction of cases removed for review from the county or district courts. These courts are usually composed of three judges and are known as superior, circuit, or district appellate courts. In some instances their decisions finally determine the rights of the parties, but as a general rule they may be reviewed by a higher court.

Supreme Courts. The highest court in most states is known as the supreme court. It consists of five to nine members. The jurisdiction of a supreme court is ordinarily appellate, although in a few instances it is original. In some states the supreme court is required to render an opinion in respect to certain questions which may be referred to it by the legislature or the chief executive of the state. The decision of the supreme court is final in all cases not involving rights and immunities under the Federal Constitution, laws, and treaties. It is final authority on questions involving a violation of the state constitution. A decision of a state supreme court, involving rights and immunities under the Federal Constitution, laws, and treaties, is reviewable by the Supreme Court of the United States.

QUESTIONS

1. F. H. Woods alleged that he suffered injuries as the result of an assault upon his person by S. W. Wilkins. He sought by an action in a court of Oklahoma County, Oklahoma, to recover from Wilkins the sum of $5,000 as damages. Should such an action properly be brought in a court of original jurisdiction or in a court of appellate jurisdiction?

2. If your right to property is based upon the judgment of the court, would it make any difference whether the judgment is obtained in a court not of record or a court of record?

3. The Superior Court of Buffalo by a statute was granted jurisdiction to determine cases involving interests in land located within the limits of the city of Buffalo, New York. The city of Buffalo brought an action in the foregoing court to acquire for park purposes and to determine the amount due for the land of Miles Wanon, which was situated in West Seneca, New York. The action was dismissed by the court. Was the dismissal proper?

4. The X Court has original jurisdiction of a few cases and supervision over the Y and Z Courts. The latter courts have original jurisdiction of some cases and supervision over several other courts. Are Y and Z Courts superior or inferior courts at common law?

5. The state of Virginia issued certain bonds under a statute which provided that the bonds were receivable for all taxes. Thereafter a statute was passed prohibiting the receipt of such bonds for taxes. A. A. McCullough brought an action against the state, contending that the second statute impaired the obligation of contract and violated a provision of the Federal Constitution. The Supreme Court of Virginia upheld the validity of the second statute. Did such a decision conclusively settle the question?

6. Metz has a claim arising out of breach of contract against Taggart for $800. He brings action against the latter in a court presided over by a justice of the peace. Is Metz entitled to judgment?

7. Jensen throws a brick through the glass front of Larimore's store. The latter wishes to bring action against him for damages. Who will present the merits of his case in court?

8. Baines contends that the sheriff enters cases upon the calendar of the court and keeps accurate record of the proceedings in each trial. Halligan contends that these duties are performed by the constable. Do you agree with Baines or Halligan?

9. E. A. Green, H. W. Voight, N. M. Christianson, and F. V. Woodworth, taxpayers of the state of North Dakota, brought an action against Governor Lynn Frazier, Attorney General William Langer, and others to enjoin the enforcement of certain state legislation. The state court held that the legislation did not violate the constitution of North Dakota. Was this decision reviewable by the Supreme Court of the United States?

10. Manning contends that everyone has a right to serve on the jury. Mears denies his contention and declares that the state requires all persons to serve on the jury at one time or another. Do you agree with either Manning or Mears?

11. Astor imports some furniture which he claims is over one hundred years old and is therefore free from import duties. The customs officials refuse to classify the articles as antiques and accordingly impose a rate for things of that kind not within the class of antiques. Is Astor entitled to take the controversy to the Court of Claims?

12. Henderson made a claim against the government for a pension. The claim was denied, and he petitioned the Court of Claims for redress. Does this court have the authority to give a judgment in respect to such a matter?

13. Boniface, who lives in Kentucky, owes $10,000 to Cass, who lives in Tennessee. Is Cass entitled to bring action against Boniface for this amount (a) in Kentucky? (b) in a Federal court?

14. The Missouri River, forming part of the boundary line between Kansas and Missouri, suddenly changes its course and runs in a new channel several miles west of its old bed. The state of Missouri claims all of the land between the old and the new beds of the river. May this controversy be tried in the first instance by the Supreme Court of the United States?

Part IV—Bringing an Action

The Summons. An action at law is commenced by the complaining party causing the party against whom the complaint is made to be notified of the nature of the claim and the fact that he should appear to answer the demand. Formal notice of this nature is known as a *summons* or a *process* and is ordinarily issued by the clerk of the court. It should contain the name of the one who makes the complaint and of the party against whom it is made; the nature of the claim and, if for money, the amount of the demand; and the time and place for appearance and defense.

> "The primary purpose of summons and its service is to give notice to defendant of the pendency of an action against him so that he may have an opportunity to be heard on the claim made against him." (Mattice v. Babcock, 52 Ida. 653, 20 P. [2d] 207)

It is important that the summons be served properly. No binding decree or judgment can be made by any court unless the defendant has been given the opportunity to defend the claim. When the action is brought against a thing or object which is within the jurisdiction of the court, it is known as a proceeding *in rem*, and actual personal notice is unnecessary. The summons may be made by publication, for the owner is presumed to watch his property and things pertaining thereto, regardless of his whereabouts. If, on the other hand, the action is *in personam*, or, in other words, is to fix some liability upon the person of the defendant, notice of the action must be served personally within the jurisdiction of the court. For example, when the owner of property located in one state resides in another, notice of an action to attach the property is valid if made by general proclamation, but an action for a judgment against him on a debt requires personal notice while he is within the jurisdiction of the court.[1]

The method of giving personal notice varies in the different states. It may be that only a designated officer can serve the summons, or it may be permissible for the plaintiff, his attorney, or some other person to give notice of the action.

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[1] *Pennoyer* v. *Neff*, 95 U. S. 714, 24 L. Ed. 565.

It may be required that the summons be actually delivered or merely left with any person found at the residence of the defendant. The manner of serving notice varies not only in the different states, but also within a given state, depending upon the nature of the cause of action. In any case, however, it is necessary to comply strictly with the terms of the statute.

Actions. At early common law an action was instituted by obtaining an original writ issued by the chancellor. There were a limited number of writs in set forms, and the petitioner was required to select the right writ, or redress would be denied, irrespective of the merits of his claim. The remedies afforded by these writs are known as *actions* and are divided into three classes—*real, mixed,* and *personal* actions.

> "Common-law actions were divided into real, personal, and mixed." (Mathews v. Sniggs, 75 Okla. 108, 182 P. 703)

Real actions are for the purpose of recovering real property. They consist of complicated and technical writs, such as the writ of dower, and the writ of entry. These actions are rarely used today, being supplanted generally by the action of ejectment which is less technical.

Mixed actions are for the purpose of recovering real property and damages for injury to the premises and for its detention. The most important writ of this class is the action of ejectment, which, as previously noted, has largely replaced the real actions used in early times. Ejectment was originally an action to give damages to a tenant who had been wrongfully ousted. Later equity recognized that this did not give adequate compensation and decreed that the tenant should be again placed in possession. Later, by alleging a fictitious lease and ouster, this action developed into an action for trying title to land.

Personal actions are for the purpose of recovering money or specific personal property. These actions are known as actions *ex delicto* and actions *ex contractu.* The latter consist of writs of debt, covenant, assumpsit, and detinue. The action of *debt* is one of the oldest common-law actions. It is used to recover a specific sum of money that is due and payable, arising from an implied or express agreement. The action of

covenant is another action known to early common law. It is used to recover a definite sum due on a sealed instrument or damages for a breach of an agreement under seal. The action of *general assumpsit* is of later origin; it is used to recover damages for the failure to perform a promise, or a sum due on a promise, which is implied from the circumstance of a particular case. The action of *special assumpsit* is to recover damages for breach of an express agreement or a sum due on an express promise. The action of *detinue* is to recover possession of personal property which is lawfully taken, but unlawfully withheld, and damages due to injury caused by its detention.

> An action by a principal against its agent to recover a balance due on account is a personal action. (Southern Union Life Ins. Co. v. Godcheaux, 15 La. A. 540, 132 S. 376)

Actions *ex delicto* are based upon violations of obligations imposed by law and not obligations imposed by consent. They consist of writs of trespass, trespass on the case, trover, and replevin. The action of *replevin* is to recover possession of personal property unlawfully taken and unlawfully detained. This action is generally governed by statute and is now used when detinue was formerly applicable. The action of *trover* is to recover the value of personal property which has been converted by another. The action of *trespass* is to recover damages for injuries to the plaintiff's person, real or personal property, or other rights, resulting from direct force or violence. The action of *trespass on the case*, or, as commonly called, the action of *case*, is used in cases which usually involve negligence. It was designed to allow recovery for indirect injuries which were not covered by the action of trespass or by other writs.

In the code states, the common-law forms of actions have been replaced by one action known as a *civil action*. This does away with the necessity of selecting the correct writ in order to obtain redress. Thus it has been stated: "The common-law rule is that, if the plaintiff declares in trespass *quare clausum* where the action should be case, he will be nonsuited at the trial; but under our system, if the facts alleged and proved are such as would have entitled the plain-

tiff to relief under any of the recognized forms of action at common law, they are sufficient as the basis of relief, whatever it may be." [2]

Pleadings. The parties to an action must reduce their controversy to proper issues before a trial may be obtained. This procedure to eliminate immaterial matters is known as the *pleadings* and consists of the formal allegations of the parties in respect to the merits of their claims. The purpose of the pleadings is not only to save time but particularly to inform the court as to the exact nature of the controversy. The pleadings or allegations alternate, each party being required to frame his response so as finally to reduce everything to definite issues. This purpose is accomplished by the allegations meeting those preceding, until finally there is an issue of law or of fact.

> "The principal purpose of written 'pleadings' is to frame and present the issues to be tried." (Tate v. Rose, 35 Utah 229, 99 P. 1003)

Each step in the process of narrowing down the field of the controversy is called a pleading, although in a strict sense the term is used to mean an allegation of the defendant of a particular nature. To a certain point each of these successive allegations has a name by which it may be distinguished. The first allegation, which is made by the plaintiff, is called a *narration*, *declaration*, or *count*.[3] The response of the defendant is called a *plea*. The plaintiff now enters a *replication*, to which the defendant makes a *rejoinder*. If no issue is raised at this point, the plaintiff counters with a *surrejoinder*. If another allegation is required of the defendant, it is known as a *rebutter*, to which, if necessary, the plaintiff replies with an allegation known as a *surrebutter*. Ordinarily an issue is raised not later than the rejoinder.

Nature of the Responses. When the defendant responds to the declaration with a statement of his claim, he may elect

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[2] *Rogers* v. *Duhart*, 97 Calif. 500, 32 P. 570.

[3] In equity procedure, this is known as a *bill of complaint* to which the defendant is entitled to demur, or make a general or special answer, the latter being known as a plea. The plaintiff may take exceptions to the answer by replication. In some instances the defendant may respond to the bill of complaint with a cross bill, which is similar to an answer.

to use one or more defenses; namely, (1) a dilatory plea, (2) a demurrer, or (3) a peremptory plea. In subsequent responses by him or by the plaintiff, a demurrer or a peremptory plea may be used. The use of these defenses, out of the order enumerated, is a bar to the use of any preceding it.

Dilatory Plea. A *dilatory* plea is a defense consisting of an allegation of some fact which, although not pertaining to the merits of the controversy, precludes a continuance of the case. To illustrate, the defendant may show that the summons was improperly served, and therefore the court does not have jurisdiction; or he may show other facts which will abate or suspend the action.[4]

> "'Dilatory pleas embrace all those defenses which only delay or defeat the present suit or action, leaving the cause of action unsettled.'" (Carmichael v. Page [Tex. Civ. A.], 32 S. W. [2d] 674)

Demurrer. This is a response which admits the allegations of fact made by the opposing party, but raises the question whether they make out a cause of action. In other words, a demurrer asserts that the facts as alleged are not sufficient to show any liability on the part of the one entering the demurrer. A demurrer raises a question of law which is decided by the judge. If a demurrer entered by the defendant is sustained, the defendant wins, because the plaintiff has failed to state a cause of action. If the demurrer is overruled, the plaintiff will win at common law, but under the rules of modern practice the defendant is usually allowed to plead.

> When there are several defendants, one against whom no cause of action is shown may demur. (Kramer v. Barth, 79 Misc. Rep. 80, 139 N. Y. S. 341)

Peremptory Plea. This is a defense which goes to the merits of the controversy. It may be in the form of a traverse or a confession and avoidance. A *traverse* is a plea which specifically or generally denies the fact or facts alleged, as when it is claimed that an agreement was made, and the execution of the agreement is denied by the other. This raises a question of fact which is usually decided by the jury but may be

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[4] *Mahoney* v. *Loan Association,* 70 F. 515.

decided by the judge upon agreement.[5] A *confession and avoidance* is a plea which admits the facts stated but alleges additional facts which show no liability, as when one claims that an agreement was made, and the other admits it but claims that his assent was procured by the use of violence. A confession and avoidance does not raise a question of either law or fact. Its effect is to compel the other party to respond to the allegations in the form of a demurrer, a traverse, or a confession and avoidance.

The Trial Docket. After the pleadings have culminated in an issue, the clerk of the court places the case on a list or calendar of actions which are ready for trial during the next term of court. This list or calendar is commonly referred to as the *trial calendar*, the *docket*, or the *trial docket*. The clerk enters the cases on this record in order of the date when the parties join in the issue. His entry gives the title of the case, the nature of the action, the names of the counsel of the parties, and the date of joining issue.

At the succeeding session of the court the docket is presented to the judge, and the cases are called for trial in the order of their appearance on the list. It is not imperative, however, that the cases be tried in the regular order, and it is not an infrequent occurrence for cases to be tried at other times. When a case is reached on the docket, it must be disposed of in one of several ways, namely, by dismissal, by postponement, by default, or by trial.

A case is disposed of by dismissal when it is sent out of court for some reason without a trial of the issues. To illustrate, a case is recorded as dismissed when the complaining party repudiates the demands made in his declaration.[6] A dismissal is ordinarily a bar to further action, except in some cases when permission to withdraw is given, as when the dismissal is entered of record as without prejudice.

The postponement of a case is known as a *continuance*, of which an entry is made in the records. The trial of an

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[5] In equity the facts are decided by the judge, or by an officer known as the master in chancery, examiner, commissioner, or auditor, who after hearing the testimony reports the facts to the judge.

[6] *Lindsay* v. *Allen*, 112 Tenn. 637, 82 S. W. 171.

action may be adjourned from one day to a later day of the same term, or from one term to the next or a succeeding term. A continuance may be obtained ordinarily by agreement of the parties, or by either for good cause, such as the inability of counsel to be present or the inability to obtain the presence of a material witness.

A case is terminated by default when the defendant who has been duly and properly notified fails to appear. Here the plaintiff wins without a trial of the issues or merits of the claim, as the defendant does in the case of a dismissal. A judgment in favor of the complaining party is entered as a *judgment by default.*

QUESTIONS

1. L. E. Everett brought an action in Edgecomb County, North Carolina, against Austin Bros. to recover damages for personal injuries. The defendants were nonresidents, and no process was served on them while they were in the state. Everett published notice of the action in the newspapers. Subsequently it was contended that the judgment obtained by Everett was not valid. Do you agree with this contention?

2. Teifel Bros. & Winn brought an action in Parmer County, Texas, against Thomas Maxwell. They alleged that Maxwell had lawfully obtained possession of certain cattle belonging to them, but that he unlawfully detained the cattle. Were the plaintiffs entitled at common law to bring an action of replevin or an action of detinue to recover possession of the cattle?

3. The formal allegations of the parties to an action for damages, arising out of a breach of contract, have reduced the controversy to an issue. Will the case now be tried immediately?

4. Pannell is suing Rueman for damages arising out of breach of contract. Rueman has been properly notified to appear in court and answer the demand. Is the case now ready for trial?

5. A proceeding in bankruptcy is brought by Seltz against Conroy in a state court. The latter responds to the plaintiff's statement of claim by showing that the action should properly have been brought in a Federal court. What is the nature of the defendant's response?

6. Reese brings an action for damages against Sennett alleging that the latter promised to make him a gift of a radio but failed to perform. Sennett admits the allegation but contends that he is not liable on a gratuitous promise. Is Sennett's response a demurrer or a peremptory plea?

7. Martinet brings an action for damages against Loesch. He alleges that the latter struck him with his fist. Loesch replies by stating that he was merely acting in self-defense. Is the defendant's plea in the form of a confession and avoidance or of a traverse?

Part V—The Trial of the Issues

Selecting the Jury. When a case is disposed of by trial, the procedure varies according to the nature of the issue before the court. If the issue is one of law, as when one party enters a demurrer to the allegation of the other, it is decided by the judge. If the issue is one of fact, its determination rests in the hands of the jury, except when by agreement the parties waive the intervention of that body and ask a finding of fact by the judge.

The persons forming the membership of a jury for a particular case are selected from the panel of qualified persons who have been summoned to appear. If there has been any fraud or other irregularity in selecting or summoning the panel, counsel for either the plaintiff or the defendant has the right to take an exception to the whole panel. This is sometimes known as a *challenge to the panel,* but more commonly as a *challenge to the array.*

> "A challenge to the array goes to illegality in drawing, selecting, or impaneling the petit jury and cannot be predicated on the disqualification of its individual members." (Lake v. State, 100 Fla. 386, 129 S. 833)

If no objection is made to the panel as a whole, then the required number of persons, ordinarily twelve, are selected from the panel by examination under the supervision of the court. Questions are asked of each in turn to ascertain whether he is incompetent or undesirable to serve on the jury for the particular case. Objections to an individual juror are known as challenges *to the polls,* as distinguished from challenges to the panel or array. A challenge of this kind may take the form of a *peremptory* challenge or a challenge *for cause.* The former consists of an objection to an individual serving on the jury which, in some cases, is valid without any reason being assigned. Such challenges are usually limited to a small number. A challenge for cause is one for which a reason for disqualification is assigned. If a prospective juror has an interest in the outcome of the case or is in some way biased or prejudiced in favor or against one of the parties, his competency may be questioned. It is highly important in the ad-

ministration of justice that each individual serving on the jury be in a position to render a fair, just, and impartial verdict in respect to the issues presented.

> A challenge for cause is "an objection to a particular juror and is: (1) General, that the juror is disqualified from serving in any case; or (2) particular, that he is disqualified from serving in the case on trial." (People v. Thayer, 61 Misc. Rep. 573, 118 N. Y. S. 855)

After the required number of persons, plus an alternate in some instances, have been accepted for the jury, they are then placed under oath to perform their duties properly. They may be sworn separately as selected, or as a body when the number is complete. The latter practice is generally followed today. After the jury is sworn, the next steps are the opening statements of counsel and the introduction of the evidence by which the parties seek to establish their claims.

Evidence. Before the evidence is presented to the jury, the counsel for the party having the affirmative side of the issue involved, ordinarily the plaintiff, makes an opening statement, outlining briefly and concisely what he intends to establish and the important parts of the evidence which is to be offered. In this connection it has been stated that "a brief summary or outline of the substance of the evidence intended to be offered, with requisite clear and concise explanations, is considered proper. But a relation of expected oral testimony at length, or a reading of expected documentary proofs at large, or any other course fitted to mislead the triers should not be tolerated." [1] Counsel for the negative side may then outline his defense or wait until the evidence to establish the affirmative side has been given.

The term *evidence* refers to any means which may be used to establish the proof of an alleged fact. It usually consists of the contents of a written document, some object which is brought in or which the jury goes to observe, or the statements of persons having direct knowledge of certain facts of which they have become aware through their senses. The

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[1] *Scripps* v. *Reilly*, 35 Mich. 371.

competency of evidence and the manner of presenting it are governed by the rules of the law of evidence which is too broad to be discussed in detail here. It is perhaps sufficient to state that the evidence must be confined to the issues, or, in other words, it must be material and relevant. Its competency depends largely upon rules relating to the nature of the evidence or to the person who is called to testify. In case of the former there are rules which exclude parol evidence and hearsay (statements by one party in regard to facts of which he has no direct knowledge but is repeating only that which has been told to him) to vary the terms of a written instrument. In the second class there are certain persons who are declared by law to be incompetent to give evidence in any or a particular case.

> " 'By relevancy is meant the logical relation between proposed evidence and the fact to be established.' " (Detroit Iron & Steel Co. v. Detroit Gray Iron Foundry Co., 240 Mich. 677, 216 N. W. 391)

At common law a person could not testify if he was a party to the action, if he possessed no religious belief, if he had been previously convicted of a felony, or for other reasons. In general these restrictions have been discarded, although some have been retained, as (with certain exceptions) in the case of a husband and a wife when one is a party to the action, and in instances involving mental capacity. Evidence offered by persons, such as young children, idiots, and insane persons, who are unable to understand the solemnity of an oath or to observe or relate faithfully the observations made, is generally considered incompetent. At common law an infant under seven years of age was presumed incompetent, and one over fourteen was presumed competent, although the presumptions could be rebutted. Between these ages no presumption was made, and competency had to be established in open court.

Testimony. The evidence given by a competent witness is known as *testimony*. It is presented to the jury by an examination in court after the witness has been placed under oath or affirmation. The counsel calling a witness makes the

direct examination or the examination in chief, after which the opposing counsel has the right to cross-examine. If the latter confuses the witness or in other ways undermines the testimony given during the direct examination, the party calling the witness may re-examine for the purpose of explanation and clearness but cannot ordinarily introduce new facts. If allowed to do so, the other side is entitled to cross-examine again. Leading questions are not proper in conducting a direct examination, except in a few instances, as when the witness turns hostile. In the cross-examination, the witness is presumed to be hostile, and such questions are permitted.

> "It is the province of cross-examination to correct any omissions of which counsel may be guilty in bringing out the facts or to test the accuracy of the witness." (People v. DeMaio, 243 N. Y. 588, 154 N. E. 616)

Witnesses are secured for the trial by means of an order from the court directing them to appear and testify at a certain time and place. This process is known as *subpoena.* If a witness fails to appear as directed, after being duly summoned, the party who called him to be summoned may ask the court to issue an attachment for him. He is then arrested and compelled to come into court and to give evidence. Unless his absence can be satisfactorily explained, he may be declared to be in contempt of court and fined or imprisoned.

If a witness lived in another state, his testimony was not available at common law. Today, however, it is generally provided by statutes that the evidence of such a person may be taken under oath and, in written form duly authenticated, may be presented in court as evidence. This practice is desirable in other instances, as when a witness is too ill to appear, when he lives a great distance from the place where court is in session and the case does not warrant the expense of travel, or when he wishes to leave the state before the case is to come to trial. The statutes specify the occasions when a deposition may be used; the manner of obtaining the same, as whether it is to be taken by a notary public, commissioner, or other officer; and the giving of notice to the other party so that he may be present for cross-examination.

Argument and Charge to the Jury. After the evidence has been submitted, counsel usually argue the case to the jury. The object of the argument is to aid and assist the jury in formulating a proper decision as to the merits of the respective claims. The argument consists of outlining the issues, discussing the material facts, arranging them so that they can be easily understood by every juror, and commenting on the credibility of the witnesses. The argument is opened and closed by the party having the affirmative side of the issue, who is ordinarily the plaintiff. Either party may waive argument at his election. The time allotted for argument may be limited by the judge or by agreement between the parties.

> " 'Argument' is a connected discourse based upon reason; a course of reasoning tending and intended to establish a position and to induce belief." (Rahles v. J. Thompson & Sons Mfg. Co., 137 Wis. 506, 119 N. W. 289)

After the arguments in a civil case, although sometimes before, the judge instructs the jurors in respect to the rules of law which govern the issues before them and in accordance with which they are to reach their conclusions. This is known as a *charge* or a *charge to the jury.* In a few states limited comment as to the evidence is permitted in the charge. Counsel have the right to request a special charge in respect to a particular point involved in the case. They are required by the rules of practice in some states to submit to the court written instructions which they believe govern the issues presented to the jury. The judge selects the instructions with which he concurs as representing the law of that state, and he so instructs the jury. The instructions furnished by counsel, whether accepted or denied, are made a part of the record.

Verdict and Judgment. The jury, after receiving the instructions as to the law governing the case, is conducted to the jury room by an officer of the court, usually the bailiff or sheriff. The members of the jury are required to remain together after starting deliberations until a decision is reached or until they are discharged because it is evident to the court that no agreement can be effected.

The decision of the jury is known as a *verdict.* It is usually in the form of a *general verdict,* which is merely a statement for the plaintiff or the defendant. In some states the jury returns a verdict in respect to specific facts, and the law is applied by the court to such facts. This is known as a *special verdict.* After agreement, if the court is in session at the time, the jury is conducted into the courtroom. When asked if a verdict has been reached, the foreman replies accordingly and delivers the verdict to the clerk who then reads it. If the court is not in session, the jurors are usually allowed to separate after placing a written report of their decision in an envelope and sealing it. This is known as a *sealed verdict.* It is read later when the court is in session. When the verdict is read by the clerk, counsel for the losing side may poll the jury, that is, he may ask each juror separately whether he then and at present concurs with the verdict. The verdict is now made a matter of record, and the jury is discharged.

> "In this jurisdiction each party to an action, civil or criminal, has the right to have the jury polled." (State v. Boger, 202 N. C. 702, 163 S. E. 877)

After the verdict, if the losing party believes that there has been some error in the procedure, or that issue was joined on an immaterial point, he may make a motion for a new trial or a repleader. If the motion is granted, the case is tried again. If the plaintiff loses and can show that the defendant won by a verdict on issues which did not constitute a valid defense, he may make a motion for a judgment *non obstante veredicto.* Upon a motion in *arrest* of judgment, the court may refuse to enter judgment when some defect is apparent on the face of the record which would render the judgment erroneous.

The usual procedure after the report of the jury is for the court to render a judgment on the verdict. This is the final determination of the respective rights of the parties. It is signed by the judge and made a matter of record. If the judgment is not reversed by an appellate court,[2] it is carried into effect by a process known as an execution.

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[2] *Post,* p. 46.

QUESTIONS

1. Who decides an issue of law?

2. Who ordinarily decides an issue of fact?

3. How does a challenge to the array differ from a challenge to the polls?

4. How does a peremptory challenge differ from a challenge for cause?

5. Of what may evidence consist?

6. The Sheridan Coal Company brought an action against the C. W. Hull Company, a wholesale and retail dealer in coal in the city of Omaha, Nebraska, to recover an alleged balance due on a shipment of coal. While cross-examining Serat, the manager of the defendant company, counsel asked: "Mr. Serat, did you call up Mr. Rogers and give him a verbal order for twenty-five hundred tons of Cherokee slack coal?" Counsel for the other side objected to the question on the ground that it was a leading question. Was the objection well made?

7. When the jury is being selected in a given trial, the defendant observes that among the members of the panel are a neighbor with whom he has had a controversy over a fence and a stranger whom he fancies will not render a fair verdict. May the defendant's lawyer disqualify these men from serving on the jury?

8. "Counsel for the party for the affirmative side of the issues makes the opening statement." What does this mean?

9. A plaintiff is required in a trial to establish proof of a fact which is the basis of his claim. How may he do so?

10. What is meant by the term *testimony?*

11. A witness in a given case is willing to testify in respect to certain facts. He lives, however, in a state other than that in which the case is to be tried. How can his testimony be used as evidence?

12. After the evidence of both sides had been submitted in a trial, the plaintiff insisted that he was entitled to open and close the argument to the jury. Do you agree?

13. In the trial of a case, witnesses testified that the defendant was driving on the wrong side of the street and that the plaintiff was driving at a speed of sixty miles an hour. The jury announced a statement in favor of the defendant. Was this a special or a general verdict?

14. A jury brought in a verdict that involved a determination of the facts of the case and of the rights of the parties to the litigation. How is it possible for a jury composed of persons without any legal training to do this?

15. The party for whom the jury returns a verdict maintains that he is now certain to obtain a judgment. Do you agree?

Part VI—Appellate Review

Removal of the Cause. When one of the parties is dissatisfied with the final decision of the lower court, he is ordinarily entitled to have the case reviewed for errors by an appellate court. This right, unless waived, may be exercised by the plaintiff or the defendant or by their heirs or personal representatives. As a general rule, the right of review is claimed by the losing party, but it may also be exercised by the party winning the action, as when he feels that he has not been fully and adequately compensated. The right to remove a case to the appellate court may be lost by waiver, as, for instance, when one accepts a settlement in terms of the judgment, or by lapse of time, as when he fails to ask for a review of the case within the period allotted by law.

> "A general purpose of the requirement of appeal bonds also is to discourage vexations and frivolous appeals." (State v. Coletti, 102 Kans. 523, 170 P. 995)

A case is reviewable today in several ways. One mode is by a *writ of error*. This is the original common-law proceeding for review and is in effect a new action requiring notice to be given to the other party. The upper court directs that the lower court remit the record of the proceedings for an examination in respect to the alleged errors. By statutes, common-law actions may also be removed to the appellate court by an *appeal*. This mode of review originated in civil law and was used in suits in equity. The method differs from that of writ of error in that it is, in effect, only a continuance of the old action and not a new one. The term *appeal* is frequently used to indicate a removal of a cause from appellate review without reference to the mode by which it is removed. In some cases the dissatisfied party may petition for a *writ of certiorari*. If this is granted, the superior court directs that the record of the case be remitted by the inferior court for the correction of errors and irregularities if any exist.

Scope of Review. At an early date the appellate court reviewed only that part of the case which related to the process, pleadings, and judgments. It was possible, however, for errors to occur in the rulings of the judge which affected the out-

come of the action but which were not treated as a formal part of the record that could be examined and corrected by the superior court. Statutes have therefore been enacted which allow the injured party to make exceptions to these rulings and orders, thus preserving them for review. The rulings, orders, and instructions to which exceptions are made are then drawn up by the complaining party with a statement of the objections and reasons for the same. They are later certified as to their accuracy by the judge who signs and seals them. This is known as a *bill of exceptions*. By the use of the bill of exceptions the upper court is enabled to examine and correct the entire proceeding of the lower court.

> "The office of a bill of exception is to bring to the appellate court for review such parts of the proceedings and facts occurring at the trial as are not required by the rules of practice to be enrolled on the order book or record of the court." (Tull v. Commonwealth, 187 Ky. 413, 219 S. W. 409)

Generally speaking, it is required that the complaining party, particularly in removing a cause by writ of error, call the court's attention specifically to the alleged errors. This is known as an *assignment of errors*; it corresponds to a declaration in the trial of the first instance. Although it must be full enough to aid the court in its examination, it cannot be couched in general terms and allegations; it must be an assignment of clear, definite, and distinct points upon which the claim for a reversal is made. Only errors to which exceptions are made and assigned will be reviewed by the court, except in a few instances, such as when the court lacks jurisdiction or when no cause of action is shown.

Ordinarily an appellate court reviews only questions of law and will not interfere with questions of fact as shown by the verdict of the jury. In some instances, however, the appellate court may inquire into questions of fact. For example, the appellate court may be authorized to pass upon questions of fact which have been found to exist by the judge when the intervention of the jury is waived.[1]

Abstract of the Record. After the requisite steps to remove a cause from the lower court to the appellate court are

[1] *Mirich* v. *Forschner Contracting Co.*, 312 Ill. 343, 143 N. E. 846.

taken, it is then necessary to fulfill the requirements which the rules of the court may prescribe for the presentation of the case. The record of the case has been ordered transmitted to the superior court. It consists of a transcript of the entire proceedings in the lower court and therefore contains many things which are necessary for the determination of the errors which have been alleged. In order to save time and to aid the court in other ways in the determination of the claim before it, many courts require that the complaining party, that is, the appellant or plaintiff in error, present a printed abridgment of the proceedings in the lower court. This is known as an *abstract of record.*

> When the entire record, without abridgment or condensation, was filed, the court declared: "Very clearly no abstract has been filed." (Hills v. Allison, 79 Kans. 617, 100 P. 651)

The requirements as to the method of presenting the abstract of the record, as well as the contents thereof, vary in different states. In general, an abstract of the record is an abridgment of the record, containing only those parts which are necessary for the determination of the points before the court. The specific contents will therefore vary with the errors which the complaining party feels have been made in the inferior court. Hence the abstract of the record may contain portions of the pleadings, particular rulings or orders of the court, parts of or all the charge to the jury, motions which have been sustained or rejected, exceptions which have been made during the trial, and other facts which are material to the points involved.

Although the abstract of the record is required to be in fact an abridgment, it must nevertheless contain all parts of the proceedings which are necessary for an adequate examination of the issue. If material parts of the proceedings are omitted, the other party is entitled to prepare a supplementary abstract of the record, showing those portions which are necessary to make the abridgment of the record complete.

Brief and Argument. Appellate courts also require counsel for the plaintiff in error or appellant to furnish a *brief.* A brief is a printed document which is filed with the court for

the purpose of informing the court as to the claim and merits thereof and, in some instances, as a basis for subsequent argument. It usually consists of four parts, although its arrangement, as well as its contents, is governed by the rules of the court.

The first part consists of a heading which recites the names of the parties, indicating which is the appellant or plaintiff in error, the court from which the cause is removed, and the name of the judge presiding in the court. The second part is a statement of the case, consisting of the nature of the action; whether it was tried with or without the intervention of a jury; the verdict or findings in respect to the facts; the entering of judgment; a brief and concise statement of the claims of the parties and of the evidence, with reference to the page where it may be found in the abstract of the record; and a conclusion indicating the contentions of the party preparing the brief. The third part consists of an enumeration of the points in dispute, each being followed by a citation of cases which tend to support the proposition stated. The last part is the argument of counsel in support of the points raised in the preceding part, together with citations to cases for authority sustaining the legal principles and to the abstract of the record for the facts involved; it is concluded by a prayer for appropriate relief.

> "The purpose of briefs is to inform the court what the points of contention are, and, by arguments on the facts and law, to enlighten the court upon the questions involved in the litigation, so that the court may be assisted thereby in the decision of the case." (Nephi Irrigation Co. v. Vickers, 20 Utah 310, 58 P. 836)

A prescribed number of copies of the brief and argument of the complaining party are filed for the use of the court and for the opposing side. When the appellee or defendant in error is supplied with a copy of the abstract of record and of the brief and argument, he must in some states, and may in others, file a printed brief and argument in reply. If, in his opinion, the plaintiff's statement of the case is not adequate, he may file a supplementary statement, which, however, must include only those things which are necessary to correct the omissions.

The practice of counsel to make oral arguments before the court varies in the different jurisdictions. It is discouraged by some courts and desired by others. Most cases are probably handled by courts upon the basis of the printed argument presented with the brief.

Disposition of the Appeal. If the appeal is not dismissed upon request of the appellant or plaintiff in error or upon the initiative of the court, as when the lower court lacked jurisdiction, the points presented for review are taken under deliberation and a conclusion announced. The conclusion of the court as to the merits of the claims of the parties is known as the *decision.*

The decision may take one of several forms. The judgment of the lower court may be affirmed, reversed, or, in some instances, modified, or the case may be remanded for a new trial. When the judgment is affirmed or reversed, with or without modification, the points involved, so far as these parties or others claiming through them are concerned, are finally and authoritatively settled. A dispute thus settled is then known as *res judicata* (a thing judicially decided).

> "The doctrine of res judicata is one of repose. It rests on two maxims: 'A man should not be twice vexed for the same cause,' and 'It is for the public good that there be an end to litigation.'" (Carter v. Monterey County Trust & Savings Bank, 3 Calif. A. [2d] 648, 38 P. [2d] 583)

The decision of a case not only settles a controversy between the parties to a particular case, but is also a guide for the future conduct of others. This is due to the fact that one of the outstanding characteristics of the common law is that a decision once made becomes a precedent to be followed in similar cases. This is known as the doctrine of *stare decisis.*

The conclusions of the court are usually announced in the form of a written statement, consisting of a statement of the claims, the arguments, an exposition of the law, illustrations, and similar matters, which tend to show how the court arrived at its conclusions. This is known as an *opinion.* It is prepared by one of the judges forming the majority. If one or more judges disagree with the majority as to the proper

conclusions, they may join in a dissenting opinion, or each may write a separate minority opinion.

It is necessary to study the opinion to determine the true principle governing a particular decision. Moreover, it is necessary to ascertain carefully what the court says in respect to the points before it. Only statements which pertain to the issues before the court are to be considered as authoritative statements of the law. All other statements, known as *dicta*, may be used only as persuasive authority. Their value, however, depends largely upon the reputation of the court making the statements.

QUESTIONS

1. James F. Henry brought an action to recover damages for personal injuries. The court overruled an objection to the question asked of a witness, and an exception was made to the ruling. Was the ruling of the court reviewable by the appellate court?

2. "The original common-law mode for removing a case to the appellate court for review is by an appeal." Do you agree with this statement?

3. Sarah A. Aram brought an action in the district court of Idaho County, Idaho, where no objection was raised as to the jurisdiction of the court to try the case. Upon an appeal, could the question of lack of jurisdiction be raised for the first time in the appellate court?

4. Finley recovered a judgment for damages against Lindley, who removed the case to an appellate court for review. In the brief prepared by Lindley, the statement of the case was inadequate. Did Finley have any remedy?

5. James Barrett brought an action against Burt Dunlap and John Miller to settle the title to the ground embraced by the Good Hope and Silver Chief mining claims situated in the state of Arizona. Subsequently he brought an action against the grantees of Dunlap and Miller. The defendants contended that the boundaries of the claims had been decided in the previous case and that the decision was binding on Barrett. Were the defendants setting up as a defense the doctrine of *stare decisis*?

6. Rankin argues that statements of a court which are known as *dicta* are without value. Do you agree?

7. A controversy between Herdman and Bangor has been tried in the lower court and removed to the highest appellate court. Will a decision by this court end the proceedings?

8. A case is removed to an appellate court. The points presented are taken under deliberation, and the conclusion is announced. Is the conclusion announced known as the opinion of the court?

CASES FOR REVIEW

1. The State Hospital for the Criminal Insane, located in Wayne County, Pennsylvania, brought a suit against the Consolidated Water Supply Company. The case turned on a question of ownership of the water in a certain reservoir. The hospital contended that the ownership of the water had been determined in a previous case and that the decision in that case is binding on the water company, which had been a party thereto. Was the hospital asking the court to recognize the doctrine of *stare decisis*? (State Hospital v. Consolidated Water Supply Co., 267 Pa. 29, 110 A. 281)

2. The Little Rock Traction & Electric Company allegedly was guilty of negligence in placing one of its guy wires within five feet of the ground and in allowing the wire to be charged with electricity. Mrs. F. F. Emrich inadvertently touched the wire and received an electric shock. If the company incurred liability for the injury, what action at common law should Mrs. Emrich bring against the company? (Emrich v. Little Rock Traction & Electric Co., 71 Ark. 71, 70 S. W. 1035)

3. A proceeding involving litigation between Elston Cromwell and Samuel Irwin was being determined in a court of Jefferson County, Washington. During this time and in the presence of the court, H. W. Buddress and Allan Trumbull used abusive, boisterous, angry, insulting, vicious language and gestures against each other and engaged in a fight. The court held them to be guilty of contempt of court. Was the court acting within its powers? (State v. Buddress, 63 Wash. 26, 114 P. 879)

4. The barge *Richmond Talbot*, owned by Charles A. Pettie, was being towed by the tug *Joseph Bartram*, owned by the Boston Tow-Boat Company, on a voyage from Stonington to Boston. The barge struck a rock in Lloyd's Channel, about three miles out from Stonington and near the east end of Wicopenet Island, and was so injured that it sank immediately. Pettie brought an action for damages against the owner of the tug, alleging that the loss was due to the negligent operation of the tug. Was he entitled to sue in a Federal court? (Pettie v. Boston Tow-Boat Co., 49 F. 464)

5. Henry Piepke brought an action to recover damages from the Philadelphia & Reading Railway Company as the result of an injury to his son, William, who was struck and injured by the tender of one of the defendant's engines that was running backward with a draft of cars. The court excluded as evidence the testimony of several boy companions of William solely upon the ground that they were only slightly over the age of seven years. Was the court right in so doing? (Piepke v. Philadelphia & Reading Ry. Co., 242 Pa. 321, 89 A. 124)

6. F. F. Williams brought an action in a court of Multnomah County, Oregon, against the Pacific Surety Company. Judgment was rendered in favor of the plaintiff, and the surety company removed the case to the

appellate court for review. The abstract of record furnished by the company allegedly did not contain many material facts necessary for a proper determination of the issue. If the allegation was true, could Williams avoid the unfairness of the situation? (Williams v. Pacific Surety Co., 77 Oreg. 210, 146 P. 147)

7. Vincenzo Maurizi was injured by falling rock while working in a mine operated in Crawford County, Kansas, by the Western Coal & Mining Company. He brought an action against the company to recover damages under a statute which provided that in case of an injury resulting from the violation of the act, "a right of action against the party in default shall accrue to the party injured." The company contended that the statute was adjective law. Was this contention sound? (Maurizi v. Western Coal & Mining Co., 321 Mo. 378, 11 S. W. [2d] 268)

8. Abraham Levy brought an action against the Swick Piano Company. After judgment was rendered, he removed the case to the appellate court for review. Upon appealing the case, Levy for the first time raised the point that the lower court did not have jurisdiction to try the case. It was contended that Levy was precluded from raising the point because of his failure to present it to the lower court. Do you agree? (Levy v. Swick Piano Co., 4 App. Div. 615, 39 N. Y. S. 409)

9. Aseneth Van Oss brought an action in Columbia County, Wisconsin, against I. H. Synon and another to recover the sum of $1,450, alleged to be due under an agreement between the parties. Was the action brought by the plaintiff classified properly as an action *ex delicto*? (Van Oss v. Synon, 85 Wis. 661, 56 N. W. 190)

10. Staight brought an action against Penter in a court of Whatcom County, Washington, to recover the sum of $700, alleged to be due and owing. The trial resulted in a judgment in favor of Staight for the sum of $200. Upon a showing of error, was Penter entitled to have the case reviewed by an appellate court? (Penter v. Staight, 1 Wash. 365, 25 P. 469)

11. The Higbee Fishing Club purchased from the executors of Jonas Higbee a lot of land. The vendors owned the land on three sides of the tract, and the West Jersey & Seashore Railroad Company owned the land adjacent to the fourth side. Thereafter, the vendors sold the land on the three sides to the Atlantic City Electric Company. The fishing club contended that it had a right of way over the land purchased by the electric company. Has the state established any agency for settling a controversy of this nature? (Higbee Fishing Club v. Atlantic City Electric Co., 78 N. J. Eq. 434, 79 A. 326)

12. M. D. Wilcox was charged by the state of South Dakota with the crime of grand larceny. There was one witness who could give as evidence certain testimony in favor of the defendant. If the witness refused to appear and to testify at the trial, did Wilcox have any remedy? (State v. Wilcox, 21 S. D. 532, 114 N. W. 687)

13. B. F. Seaton and Edward L. Swem were engaged in litigation in a court of Linn County, Iowa. One of the persons selected to be a member of the jury was A. Caldwell, who had made a bet upon the outcome of the trial. Counsel for Seaton contended that he was entitled to disqualify Caldwell as a juror. Was this contention sound? (Seaton v. Swem, 58 Iowa 41, 11 N. W. 726)

14. Roberts, of New York City, owned the *Moses Taylor*, a steamship, and was engaged in carrying passengers and freight between Panama and San Francisco, California. He entered into a contract to transport Hammons between these ports with reasonable dispatch and to furnish Hammons with the proper and necessary food, water, berth, and other conveniences for lodging on the voyage. Hammons later alleged breach of contract in that he was detained at the Isthmus of Panama eight days, that the food was unwholesome, and that he was placed in a cabin without sufficient room or air for health or comfort. Was Hammons entitled to bring an action for damages in a Federal court? (The Moses Taylor v. Hammons, 4 Wall. [U. S.] 555, 18 L. Ed. 397)

15. Buchner owned and occupied as a homestead a lot of about an acre and a half of land in the city of Waukesha, Wisconsin. The Chicago, Milwaukee & Northwestern Railway Company constructed its track very close to the lot owned by Buchner. Thereafter, Buchner brought an action against the company to recover damages. Upon an appeal of the case, Mr. Justice Lyon in an opinion made certain statements as to the law in respect to an issue that was not before the court. Were such statements known as *res judicata*? (Buchner v. Chicago, M. & N. Ry. Co., 60 Wis. 264, 19 N. W. 56)

16. George K. Neher brought an action in a court of Bernalillo County, New Mexico, against Ambrosio and Anita Armijo to obtain a partition of certain land situated in the city of Albuquerque. Both the plaintiff and the defendants claimed that during the trial errors occurred that were prejudicial to them. Could only one of the sides remove the case to the appellate court for review? (Armijo v. Neher, 11 N. M. 354, 68 P. 914)

17. The New Orleans Seed Company, of New Orleans, Louisiana, was engaged in the business of purchasing and selling cottonseed. It owned many thousands of sacks with its name on each container. These sacks were distributed to producers for the shipment of cottonseed to the company. Agents of the Warren Mills Company used these sacks against frequent objections of the seed company. It was impracticable for the seed company to sue the Warren Mills Company in a court of law for damages because of the vexation and expense attached to the large number of actions required. Was the seed company without a remedy? (Warren Mills Co. v. New Orleans Seed Co., 65 Miss. 391, 4 S. 298)

CHAPTER I

CONTRACTS

Part I—General Considerations

Introduction. The basis of trade and commerce today is the enforceability of promises. It would be impossible to carry on our present co-operative exchange society without some method of enforcing promises of future conduct. Any business which requires the employment of assistants, whether it is in marketing, production, finance, transportation, or some other field, proceeds to some extent in reliance upon the future conduct of others. The success of any particular venture hinges upon performance in conformity with the expected conduct. It is obvious that some measure of assurance in respect to such promises is necessary in order that undertakings over a period of time may be started with reasonable expectation of completion. It is with the enforceability of these promises that the law of contracts is concerned.

The law of contracts, as we know it today, had its beginning about the middle of the thirteenth century. Previous to this period England was essentially a nontrading nation. Certain promises were enforced by the courts, either because they were formally and solemnly executed or because the breach thereof caused a wrong which was regarded as a tort. The enforcement of simple promises had in general no place in the social organization as it existed at that time. As England ceased to be an agricultural nation, and commerce and trade were gradually introduced, the need for the assurance of future conduct, particularly the enforcement of simple promises, became apparent. Slowly, step by step, during the fourteenth, fifteenth, and sixteenth centuries, the law developed under the demands and pressure of business requirements until finally simple promises became enforceable.

Every person engaged in economic activities has a vital interest in the enforceability of promises, not only because trade and commerce consist essentially of exchanges of prom-

ises, but also because all are in some measure in contact with a contractual relation. There are some who, in dealing with others, make and accept promises many times daily. It is their task to create contractual relations, perhaps as agents for large corporations. The same is true of the small merchant whose transactions consist of infrequent purchases and numerous small sales. In every phase of the economic world, one finds contact with promises, the enforcement of which is of interest to him. Even one who is employed only for the purpose of performing some ministerial duty, insignificant and humble as the task may be, comes in contact with at least one promise, namely, that of employment. It is therefore important that everyone engaged in the business world should have some appreciation of the principles governing the law of contracts. He should have some appreciation of the elements necessary to create an enforceable promise, its operation and effect, the rights and duties established, and the termination of such rights and duties.

Definition. In the broadest sense, "a contract is a promise or set of promises for the breach of which the law gives a remedy or the performance of which the law in some way recognizes as a duty. Restatement, Contracts, Sec. 1." [1] Most contracts, however, arise out of agreements; hence contracts are customarily defined in this narrower sense. Thus, a contract has been defined as "an agreement creating an obligation." [2] Because it is difficult to formulate a complete and satisfactory definition, one may find practically as many definitions as there are writers on the subject. Nevertheless, generally speaking, a *contract* is an exchange of assents by two or more persons, resulting in an obligation to do or to refrain from doing a particular thing, which is recognized or enforced by law.

The terms "agreement" and "bargain" are often used interchangeably. It should be noted, however, that the term "bargain" may be used in a narrower sense than the term

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[1] *Stentor Electric Mfg. Co.* v. *Klaxon Co.*, 115 F. (2d) 268.
[2] *H. Liebes & Co.* v. *Klengenberg*, 23 F. (2d) 611.

> "agreement" and may be applied only to a particular class of agreements, as for example, agreements "to exchange promises or to exchange promises for performances." (Restatement, Contracts, Sec. 4)

There is embodied in the foregoing definition the idea that by mutual assent the parties create a legally enforceable obligation which did not previously exist. The difficulty in formulating a satisfactory definition of a contract is due to the fact that it is a complicated concept embodying many elements. In terms of these elements, a contract may be defined as (1) a valid agreement, (2) based upon real or genuine assent, (3) supported by a valid consideration, (4) having a lawful object, (5) between competent parties, and (6) made in the form required by law.

Formal and Simple Contracts. Contracts are classified in terms of their form as (1) contracts under seal, (2) contracts of record, and (3) simple or parol contracts. The first two classes are known as formal contracts, their validity being based upon form alone.[3]

Contracts under Seal. When the terms of an obligation are written or printed upon paper or parchment and are signed, sealed, and delivered, the obligation constitutes a contract under seal.[4] An instrument of this nature is technically known as a *deed.* It is also called a *common-law specialty.* The most important feature of this form of contract is the seal, without which the contract is not a specialty or deed.

A contract is sealed when it is executed by affixing a seal, or, in other words, by making an impression upon the paper or upon some tenacious substance attached to the instrument. Although at common law an impression was necessary, the courts now treat various signs or marks, made formally in attestation, to be the equivalent of a seal.[5] To illustrate, in

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[3] R., Sec. 3. The Restatement includes in the class of formal contracts negotiable instruments (see Chapter IV) that are commercial specialties as distinguished from sealed contracts that are common-law specialties.

[4] R., Sec. 8.

[5] R., Sec. 96.

some states a sufficient substitution consists in the use of a scroll or scrawl, the word "seal," or the letters "L. S." [6] When devices are used as substitutes for the common-law seal, however, some states require that the instrument recite that it is intended to be a contract under seal. For example, the signature "H. C. Walker (Seal)" with such a recital was held to be a promise under seal; whereas the signature "Church Lumber Co. (Seal)" without such a recital was held not to be a promise under seal.[7]

> It is possible for two or more persons to use the same seal. When the first signer only affixes a seal to signature, the subsequent signers, if they deliver the instrument, are presumed to have adopted the seal "unless extrinsic circumstances show a contrary intent." (Restatement, Contracts, Secs. 98 and 99)

Contracts of Record. Obligations imposed by the judgments of a court and entered upon its record are often called contracts of record. For the most part, however, judgments, which are really opposed by the parties against whom they are rendered, cannot accurately be described as contracts. One form of contract of record is in fact a contract. It exists when one acknowledges before a competent court that he is bound to pay a specified sum unless a specified thing is done or not done. For example, a debtor in this manner binds himself to pay a certain sum in the event that he fails to apply to a court for a time and place for an examination within thirty days after his arrest on an execution in favor of a creditor.[8] An obligation of this kind is known as a *recognizance.*[9]

Simple or Parol Contracts. All contracts other than contracts of record and contracts under seal are called simple or parol contracts.[10] Although the word *parol* strictly means by *word of mouth,* the term is employed interchangeably with

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[6] *Stern* v. *Lieberman,* 307 Mass. 77, 29 N. E. (2d) 839.
[7] *Marshall* v. *Walker,* 50 Ga. A. 551, 178 S. E. 760.
[8] *Modern Finance Co.* v. *Martin,* 311 Mass. 509, 42 N. E. (2d) 533.
[9] R., Sec. 9.
[10] R., Sec. 11.

the word *simple* and is applied to all contracts, except those noted previously, whether they are in writing or are merely oral.

Express, Implied, and Quasi-Contracts. Contracts may be classed also in terms of their formation, as (1) express contracts, (2) implied contracts, and (3) quasi-contracts. Those in the last class, however, are not really contracts.[11]

Express Contracts. An express contract is one in which the parties have made an oral or written declaration of their intentions and of the terms of the transaction. In other words, "an express contract is one, the terms of which are stated in words. Sec. 1620, Civil Code." [12]

Implied Contracts. An implied contract, or, as sometimes stated, a contract implied in fact, is one in which the evidence of the agreement is not shown by words written or spoken, but by the acts and conduct of the parties. "Such a contract arises where a plaintiff, without being requested to do so, renders services under circumstances indicating that he expects to be paid therefor, and the defendant, knowing such circumstances, avails himself of the benefit of those services." [13]

Quasi-Contracts. Under certain conditions the law enforces legal duties and obligations when no real contract express or implied, exists. These obligations are known as quasi-contracts. "A quasi or constructive contract rests upon the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. In truth it is not a contract at all. It is an obligation which the law creates, in the absence of any agreement, when and because the acts of the parties or others have placed in the possession of one person money, or its equivalent, under such circumstances that in equity and good conscience he ought not to retain it, and which *ex aequo et bono* (in justice and fairness) belongs to another. Duty, and not a promise or agreement or intention of the person sought to be charged, defines

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[11] R., Sec. 5(a).
[12] *Grant* v. *Long*, 33 Calif. A. (2d) 725, 92 P. (2d) 940.
[13] *Collins* v. *Lewis*, 111 Conn. 299, 149 A. 668.

it. It is fictitiously deemed contractual, in order to fit the cause of the action to the contractual remedy." [14] These obligations are sometimes called contracts *implied in law*. This is objectionable, not only because such obligations lack the essentials of contracts, but because this creates confusion in respect to real contracts resulting from acts or conduct which are properly called implied contracts.[15]

Valid, Voidable, and Void Contracts. Contracts may be classified also in terms of their enforceability. Upon this basis they may be divided into (1) valid contracts, (2) voidable contracts, and (3) void contracts.

Valid Contracts. An agreement that is binding and enforceable is called a valid contract. It has all the essential requirements previously mentioned, which will be discussed later.

Voidable Contracts. This form of contract is an agreement which may be binding and enforceable, but due to the lack of one or more of the essentials of a valid contract, it may be rejected at the option of one or either of the parties.[16] It will be noted later that one may in some instances avoid liability on an agreement into which he has been forced to enter.[17] If the party having the right to avoid his obligation does not exercise the right, the agreement is binding and enforceable.

If the party exercising the right to avoid the transaction has transferred property to the other party, he is entitled to recover the value of such property. Under some circumstances he is entitled to a decree specifically restoring the property to him. Even then, he is denied this right when he seeks to avoid an agreement on certain grounds, as in case of fraud, if the property has been acquired by an innocent third person in good faith and for value.

Void Contracts. Void contracts are really not contracts at all. The term means agreements which are without any legal

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[14] *Miller* v. *Schloss*, 218 N. Y. 400, 113 N. E. 337.
[15] *Hancock* v. *Village of Hazel Crest*, 318 Ill. A. 170, 47 N. E. (2d) 557.
[16] R., Sec. 13.
[17] *Post*, p. 81.

effect. Thus, where an agreement contemplates the performance of an act prohibited by law, it is usually incapable of enforcement; hence it is void.[18]

Executory and Executed Contracts. Contracts may be classified in terms of performance as executory contracts and executed contracts.

Executory Contracts. This class of contracts is composed of undertakings in which one or both parties are under an obligation to do or not to do certain things. In other words, under the terms of the contract something remains to be done. For example, if a utility company has an agreement to furnish electricity to another party for a specified period at a stipulated price, the contract is executory.[19] If the sum has been paid in advance, the contract is still deemed executory; although, strictly speaking, it is executed on one side and executory on the other.

Executed Contracts. These contracts are such as have been completely performed. In other words, an executed contract is one under the terms of which nothing remains to be done by either party. A contract may become executed in the future by its terms being carried out in due time; or it may become executed at once, as in the case of a cash sale. In such an instance the transaction is completed at the time the contract is made.[20]

QUESTIONS

1. "It would be impossible to carry on our present co-operative exchange society without some method of enforcing promises of future conduct." Do you agree with this statement?

2. The Farmers' Union of Breckinridge County, Kentucky, appointed a committee, composed of E. H. Tucker and others, to sell its tobacco. An agreement was made by the committee with Jarbo, a partner in the firm of Pete Sheeran & Co. During subsequent litigation over the company's failure to carry out the agreement, it was contended that not all agreements are contracts. Do you agree with this contention?

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[18] *Post*, p. 103.
[19] *Keokuk* v. *Ft. Wayne Elect. Co.*, 90 Iowa 67, 57 N. W. 689.
[20] *McNett* v. *Cooper*, 13 F. 586.

3. Rosa Hager brought an action in a court of Ellis County, Kansas, against Rufus L. McDonald and others. She recovered a judgment for the sum of $10,734. During subsequent litigation the court declared that a judgment fell into one of three classes of contracts. Into which class did he place judgments?

4. During one morning W. H. Head executes three contracts as agent for his company. First, he orders by telephone ten tons of coal to be delivered at his plant. Second, he accepts an order for a given quantity of the company's product to be delivered to the buyer within ten days. Third, he executes and delivers a thousand-dollar bond to one of the company's customers. Classify these contracts in terms of their form.

5. William J. Alt brought an action to eject Ambrose E. Stoker from forty acres of land situated in Cape Girardeau County, Missouri. The plaintiff claimed title under a sealed contract executed by John R. Henderson. The defendant contended that the contract was not properly sealed because there was no impression upon the paper or upon some tenacious substance attached to the instrument. Does a sealed instrument require such an impression?

6. H. T. Reid brought an action against James Sprout to recover possession of eighty acres of land in the Half-Breed Tract, situated in Lee County, Iowa. He claimed title under a former judgment for partition. During the litigation it was contended that a judgment was really not a contract. Do you agree?

7. "If a person pays an obligation which another is under a duty to perform, the law gives the former a contractual remedy to recover the amount." Is this statement accurate?

8. Dawkins maintains that the obligation of the person under a duty to repay the one who acted in his behalf is called a quasi-contract. Do you agree?

9. James Foster was entitled, upon the ground of fraud, to avoid liability on a contract made with E. R. Jenkins. Was the contract void or voidable?

10. Clarence Ford and Andrew Carlin executed a contract under which neither party had performed. Classify the contract in terms of performance.

Part II—The Agreement

Apparent Mutual Assent. An agreement consists of an offer and an acceptance.[1] There must be two or more parties to the transaction. As it is imperative that there be a concurrence of at least two minds, it is impossible for one person to make an agreement with himself. To illustrate, when a person in his official capacity, as a president of a corporation, makes a promise to himself, as an individual, no agreement is formed by an acceptance in the latter capacity.[2]

An agreement is sometimes said to require the meeting of minds with the same intention. This is inaccurate, as courts must necessarily concern themselves with what the parties appear to mean and not with what they actually mean. "If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms." [3] In other words, there is an agreement when the parties lead each other reasonably to believe that they are of the same mind about a given transaction.[4] This point is reached by an apparent offer on the one side and an apparent acceptance on the part of the other.

> "It is not the subjective thing known as meeting of the minds, but the objective thing, manifestation of mutual assent, which is essential to the making of a contract." (Benedict v. Pfunder, 183 Minn. 396, 237 N. W. 2)

An agreement may originate in one of several ways. First, there may be an offer of a promise and a simple assent. This is possible only when the promise is under seal or of record, in which case it is binding because of its form alone. Second, there may be an offer of an act for a promise, as when a public motor coach by running on its route makes an offer of its

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[1] R., Sec. 22.
[2] *Sinclair Refining Co.* v. *Long*, 139 Kans. 632, 32 P. (2d) 464.
[3] *Smith* v. *Hughes*, L. R. 6 Q. B. 597.
[4] R., Sec. 22(a).

services for the promise of the one entering to pay his fare. Third, there may be an offer of a promise for an act, as when one promises to pay a specified sum for the performance of an act, such as the returning of lost goods. Fourth, an agreement may originate in an offer of a promise for a promise, as when one person offers to pay fifty dollars in return for the promise of another to paint his automobile. The first three methods result in *unilateral* contracts, because in each instance there is an obligation to perform on the part of only one party. The fourth or last method creates a *bilateral contract*, in that there is an obligation on the part of both to do or to refrain from doing a particular thing.

The Offer. An offer is a proposal by one person, known as the *offeror*, whereby he expresses his willingness to enter into an obligation binding him, or the party to whom the offer is made, or both, to do or not to do a particular thing.[5] There are two requisites to a valid offer: First, it must be made with the apparent intention of creating a legal relation; and, second, it must be definite and certain.

One frequently makes proposals or statements of intention under certain circumstances without a thought or intention of creating a binding obligation. While laboring under the stress of great emotion or excitement, one may make a statement that cannot be treated as an offer on account of the fact that it would be obvious to a reasonable person that a legal relation is not contemplated. For example, where a man from whom some old harness of small value had been stolen, while denouncing the thief vehemently, stated that he would give one hundred dollars for the apprehension of the culprit, it was held that the offer was made under such circumstances that it could not be turned into an agreement.[6] The same is true when a statement is intended as a jest. To illustrate, where a man offered a very valuable race horse for a thirteen-dollar watch, it was held that the statement was clearly not intended to be an offer; hence it was not binding upon an acceptance.[7]

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[5] R., Sec. 24. The Restatement defines an offer as a promise conditional upon an act, a forbearance, or a promise.

[6] *Higgins* v. *Lessig*, 49 Ill. A. 459.

[7] *Kellar* v. *Holderman*, 11 Mich. 248.

The basis for these decisions is that one has no right to rely upon a statement that is obviously not intended to be an offer.[8] It should be remembered, however, that one is bound by what he leads another reasonably to believe; hence, one may in fact be jesting or acting under stress of great emotion or excitement, but he will be bound by his statement if another is reasonable in believing that he is serious.

> In an action involving an alleged contract, H. A. Canney asserted that he had merely jokingly said that he would buy certain cattle from Dietrick, but that he had no intention of so doing. The court said: "A party cannot avoid a contract upon the ground that he was merely jesting if his conduct and words were such as to warrant a reasonable person in believing he was in earnest." (Dietrick v. Sinnott, 189 Iowa 1002, 179 N. W. 424)

Another form of statement not ordinarily regarded as an offer is found in those cases in which a merchant, to obtain an increase in trade, sends out circulars announcing certain goods for sale on specified terms or broadcasts announcements of auction sales. These statements are not intended to be offers, and they are treated by courts as being merely invitations to deal.[9] The same is true when quotations are sent out by the merchant. "It is a matter of common knowledge that quotations of prices are scattered broadcast among possible customers. Business could not be carried on if each recipient of a priced catalogue offering a desirable article—say a rare book—at an attractive price were in a position to create a contract of sale by writing that he would buy at the price mentioned.....A merchant, dealer, or manufacturer, by furnishing a quotation, invites an offer which will be honored or not according to the exigencies of his business." [10]

> The Courteen Seed Company received from G. B. Abraham the following wire: "I am asking 23 cents per pound for car of red clover seed from which your sample was taken." It was held that the wire was merely an invitation to negotiate and did not constitute an offer. (Courteen Seed Co. v. Abraham, 129 Oreg. 427, 275 P. 684)

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[8] R., Sec. 71(c).
[9] R., Sec. 25.
[10] *Boyers & Co.* v. *Duke*, 2 Irish Rep. 617.

The second requirement of a valid offer, as stated above, is that it must be definite and certain.[11] When an offer is vague, uncertain, or indefinite, it cannot be turned into a binding obligation, because it would be impossible for the court to enforce it. Unless the court can determine the extent of the undertaking, it cannot enforce the promise. Thus an offer of a person to conduct a business for such time as it should be profitable is too vague to constitute a valid offer.[12]

Communication of the Offer. An offer may be evidenced by either words or actions; but until an offer is made, there can be no acceptance. For example, when there is an offer made today to pay a sum of money for the capture of a certain thief, one who captured the specified thief yesterday obviously cannot be said to have accepted the offer, for at the time of the act there could not have been an intent to accept such offer. Even if the offer had been made before the capture of the thief, it does not follow that the doing of the act constitutes an acceptance. In such case it is necessary that the act be done with the intent to accept the offer. An agreement is an exchange of assents; consequently it cannot exist when the offer is unknown to the person who purports to accept. An offer must therefore be communicated to the offeree.[13] For example, when one promises to pay for the services of another, and the latter performs such acts without knowledge of the offer, there is no binding obligation.[14]

> Holding that a letter written a year before a death-benefit plan had been offered by an employer could not be an acceptance, the court declared: "An offer may not be accepted until it is made and brought to the attention of the one accepting." (Trimble v. New York Life Ins. Co., 234 App. Div. 427, 255 N. Y. S. 292)

In cases of offers of a reward, a few states have held that one may recover by performing the services requested, although at the time he may be ignorant of the offer. Most states, however, follow the rule which requires knowledge of the offer. Thus it has been stated that "to the existence of a

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[11] R., Sec. 32.
[12] *Pulliam* v. *Schimpf*, 109 Ala. 179, 19 S. 428.
[13] R., Sec. 23.
[14] *Ball* v. *Newton*, 7 Cush. (Mass.) 599.

contract there must be mutual assent, or, in another form, offer and consent to the offer. The motive inducing consent may be immaterial, but the consent is vital. Without that, there is no contract. How, then, can there be consent or assent to that of which the party has never heard?" [15]

Revocation of the Offer. An offer alone creates no obligation on the part of the offeror, even when it is communicated. Until it has been turned into an agreement by an acceptance, the offer may be withdrawn.[16] Thus, "a bidder at a sheriff's sale has a right to withdraw his bid at any time before the property is struck down to him, and the sheriff has no authority to prescribe conditions which deprive him of that right. Where a bid is thus withdrawn before acceptance, there is no contract, and such a bidder cannot, in any sense, be regarded as a 'purchaser.' " [17]

> The Orr Drug Company made an offer to purchase a cash register which was transmitted by the salesman to the home office for acceptance. The offer was withdrawn before the home office had taken any action with respect to the offer, and a subsequent acceptance did not create a contract. (Remington Cash Register Sales Co. v. Orr Drug Co., 45 Ga. A. 66, 162 S. E. 920)

The offer may be withdrawn, although its terms may expressly state that it will be open for a certain period. This is equally true even when the offeror promises to keep it open for a certain time, except when he has been paid to keep it open.[18] In the latter case the transaction is known as an *option* or *option contract,* and the offer cannot be withdrawn before the end of the period specified in the agreement. Another exception to the general rule is that at common law an offer under seal cannot be revoked.[19]

> In a lease of land for a baseball park, the lessors offered to sell the premises, the offer to remain open during the first year of the lease. Because the payment of rent was a consideration for the offer, the lessors could not revoke the offer. (Tebeau v. Ridge, 261 Mo. 547, 170 S. W. 871)

[15] *Fitch* v. *Snedaker,* 38 N. Y. 248.
[16] R., Sec. 41.
[17] *Fisher* v. *Seltzer,* 23 Pa. 308.
[18] R., Sec. 47.
[19] R., Sec. 46.

A revocation of an offer, as in the case of the offer itself, is usually operative only when notice thereof is received by the offeree. Notice of a withdrawal is usually expressly and formally given, but such is not necessary. When the offeree learns of facts clearly indicating that the offeror withdraws his offer, the revocation is operative.[20] Thus, when one makes an offer but, before receiving an acceptance, notifies the offeree that the subject matter has been sold, such notice is an effective withdrawal of the offer.[21]

> Bemis & Wilsie sent an order for goods to J. L. Owens Company. Before the offer was accepted, the offeree received a letter from the offerors, requesting cancellation of the order. It was held that there was sufficient notice of revocation. (J. L. Owens Co. v. Bemis, 22 N. D. 159, 133 N. W. 59)

Actual notice is ordinarily required, but this is not always true. When the offer is made to the public at large, it may be revoked in the same manner in which it is made.[22] In such case, it is immaterial that the person attempting to accept did not have knowledge of the withdrawal. For example, where a reward for the arrest of a criminal was made and withdrawn, after which a person made the arrest without knowledge of the revocation, it was held that the reward could not be recovered and that ignorance of the withdrawal in such a case was immaterial. The court stated: "The offer not having been made to him directly, but by means of a published proclamation, he should have known that it could be revoked in the same manner in which it was made." [23]

Who May Accept. Communication of the offer, however, does not mean that anyone may accept it. Only the offeree is entitled to turn the offer into an agreement, and an acceptance by any other party is ineffective.[24] Thus, there was no contract when an offer to buy goods was sent by a foundry to J. H. Menge & Sons and was accepted by Arthur D. Parker,

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[20] R., Sec. 42.
[21] *Thurber* v. *Smith*, 25 R. I. 60, 54 A. 790.
[22] R., Sec. 43.
[23] *Shuey* v. *The United States*, 92 U. S. 73, 23 L. Ed. 697.
[24] R., Sec. 54.

a receiver, the court declaring that it is elementary law that "a party has a right to select and determine with whom he will contract and cannot have another thrust upon him without his consent." [25]

> Rodliff and others, dealers in wool, offered to sell twenty bags of wool to a manufacturer. Clementson, another wool dealer, attempted to accept the offer. It was held that there was no sale. (Rodliff v. Dallinger, 141 Mass. 1, 4 N. E. 805)

An offer may, however, be made to the public in general, in which case it may be accepted by any one having knowledge of such offer.[26] Merchants may and sometimes do offer to pay a specified sum of money to anyone who purchases and uses their goods and finds that they do not possess the qualities claimed. Offers to the public in general are usually offers of rewards. For example, where a man addressed the spectators at a fire, stating that he would pay a given sum to anyone who recovered the body of his wife from the burning building, his statement was held to be an offer to the public which was validly accepted by one of the group performing the act.[27]

The Acceptance. An acceptance is an assent to the terms of the offer given by the party to whom the proposal is made, or, in other words, the offeree.[28] As in the case of the offer, the acceptance may be express or implied from conduct. There are three general ways of making an acceptance: first, by mere assent, as in the case of a sealed offer; second, by a promise when it is requested; and third, by an act, a forbearance, or a selection from terms offered.[29]

> H. A. Swindle subscribed for a newspaper for six months. After this period, the paper was sent regularly to Swindle, who gave no notice to stop but continued to take the papers from the mail box and to read them. It was held that there was an implied contract to pay for the papers. (Prospect News Printing Co. v. Swindle [Mo. A.], 15 S. W. [2d] 922)

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[25] *Parker* v. *Dantzler Foundry & Mach. Works*, 118 Miss. 126, 79 S. 82.
[26] R., Sec. 28.
[27] *Reif* v. *Paige*, 55 Wis. 496, 13 N. W. 473.
[28] R., Sec. 52.
[29] R., Sec. 29.

Generally speaking, mere silence or inaction on the part of the offeree will not constitute an acceptance.[30] In the absence of circumstances which impose a duty to speak, the offeree does not become bound by contract merely because he refuses or neglects to reply to the offer. "The hearing of a request and not answering it is as consistent, indeed more consistent, with a dissent than an assent. If one is asked for alms on the street and hears the request, but makes no answer, it certainly cannot be inferred that he intends to give them." [31] In a few instances an acceptance will be inferred from silence or inaction, but only when previous dealings or other circumstances place the offeree under a duty to speak or act.[32]

An obligation on the part of the offeree to speak, to act, or to forbear, however, cannot be imposed by the offeror alone. In other words, the offeror cannot frame his offer in such terms as to make silence amount to an acceptance. For example, when an insurance agent wrote that he would insure the premises of another "unless notified to the contrary," but the offeree did not reply, it was held that no agreement was made.[33] If, however, the offeree in compliance with the terms of the offer remains silent with the intent to accept, a contract is formed.[34] The demand for silence as an acceptance is like a demand for any other ambiguous act or forbearance, and the creation of a contract should depend upon the intent of the offeree.

> "Under some circumstances, where the offeree fails to reply to the offer, his silence and inaction may constitute an implied acceptance, but circumstances may be such that acceptance will not be presumed. Amer. Institute Restatement, Contracts, vol. 1, Sec. 72." (Shulman v. Hartford Public Library, 119 Conn. 428, 177 A. 269)

The acceptance must be absolute and unconditional and made strictly in accordance with the terms of the offer.[35] The offeror is entitled to stipulate in his proposal the time, mode,

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[30] *Wold* v. *League of Cross of Archdiocese of San Francisco*, 114 Calif. A. 474, 300 P. 57.
[31] *Royal Ins. Co.* v. *Beatty*, 119 Pa. 6, 12 A. 607.
[32] R., Sec. 71(a) and (c).
[33] *Prescott* v. *Jones*, 69 N. H. 305, 41 A. 352.
[34] R., Sec. 71(b).
[35] R., Secs. 58 and 60.

and place of acceptance, or any other terms which he may fancy. There can be no agreement unless there is a concurrence in the exact things proposed. "It is elemental that, in order to give rise to a valid contract, the acceptance must in every respect correspond substantially with the identical offer made. The acceptance must be absolute and unconditional, and, if conditions are attached or if it differs from the offer, the transaction amounts only to a proposal and a counterproposal." [36] Hence, when the place or mode of acceptance is prescribed, an acceptance at any other place or in any other manner is ineffective, and there is no contract unless the offeror assents to the counterproposal. So, also, if the offer states the time for an acceptance, no agreement is formed by an acceptance at a later date, unless the offeror assents.[37] When the answer is requested by return mail, it is usually held to mean that the letter must be posted not later than the day the offer was received.

Communication of the Acceptance. Although an acceptance must be evidenced by some overt act, it is not always required that the acceptance come to the knowledge of the offeror. If the offer requests an acceptance by a promise on the part of the offeree, then communication of such acceptance to the offeror or his agent is required. Under such circumstances a communication of an acceptance to any other party would be insufficient. On the other hand, the offeror may waive the requirement of notification, if he desires, as it is for his benefit. Ordinarily, therefore, when an offer by its terms stipulates an act for an acceptance, communication of the acceptance is not necessary.[38] Thus it has been stated that "it is elementary that when an offer has indicated the mode or means of acceptance, an acceptance in accordance with that mode or means is binding on the offeror." [39]

A mother promised to permit the use of certain premises in Maine in return for her daughter and son-in-law moving

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[36] *Marshall Mfg. Co.* v. *Berrien County Package Co.*, 269 Mich. 337, 257 N. W. 714.
[37] R., Sec. 61.
[38] R., Sec. 56.
[39] *Davis* v. *Jacoby*, 1 Calif. (2d) 370, 34 P. (2d) 1026.

from Missouri and caring for her. The offerees moved to Maine from Missouri and began caring for the offeror. It was held that a contract was formed by performance of the requested acts. (Brackenbury v. Hodgkin, 116 Me. 399, 102 A. 106)

The rule that notification of the acceptance is not necessary in cases of an offer requesting an act is not applied in many states when the offer is of guaranty for credit extended or money advanced. This is apparently an exception to the rule stated above, and is placed on the ground that "if the act is of such kind that knowledge of it will not quickly come to the promisor, the promisee is bound to give him notice of his acceptance within a reasonable time after doing that which constitutes the acceptance. In such a case it is implied in the offer that, to complete the contract, notice shall be given with due diligence, so that the promisor may know that a contract has been made." [40] The Restatement adopts the view in such cases that performance is the acceptance, and failure to give proper notice is a condition subsequent which discharges the offeror.[41]

"It is only in the exceptional case where the offeror has no convenient means of ascertaining whether the requested act has been done that notice is requisite. Even then, it is not the notice which creates the contract, but lack of the notice which ends the duty." (Ross v. Leberman, 298 Pa. 574, 148 A. 858, quoting authors of the Restatement, Contracts, Sec. 56)

When an agreement is made by correspondence, the acceptance is generally held to operate when it is posted, and it is binding although lost in the mails.[42] This rule may be explained on the theory that the offer impliedly requests an acceptance by an act of posting the letter; hence a contract is formed even though the letter is lost or is reclaimed by the sender and destroyed. The same rule also applies when the offer and the acceptance are made by means of telegrams.[43] Thus, an offer to purchase cotton made by wire authorizes an accept-

[40] *Bishop* v. *Eaton*, 161 Mass. 496, 37 N. E. 665.
[41] R., Sec. 56.
[42] R., Sec. 64.
[43] R., Sec. 66.

ance by wire, and an acceptance so made is effective when deposited for transmission, even though the telegram is not delivered to the offeror.[44]

> An offer for advertising space in Baedeker's International Trade Developer was sent by mail to the Des Moines Morris Plan Company. An acceptance was mailed at Des Moines, properly addressed to the offeror at Washington, D. C. The acceptance was operative when it was posted at Des Moines, Iowa. (International Transp. Assn. v. Des Moines Morris Plan Co., 215 Iowa 268, 245 N. W. 244)

There are three exceptions, however, to the rule that the posting of a letter, or the delivery of a message of acceptance to the telegraph company, constitutes an acceptance. First, the act does not complete the agreement when, in the terms of the offer, the offeror stipulates that the acceptance must be actually received. Second, it does not constitute an acceptance if the means of transmission are not proper. Thus, when the offer is delivered personally, and from the circumstances it is not fairly inferable that the offeror contemplated an acceptance by mail, an acceptance by mail does not operate when placed in the mails.[45] If, however, when the offeree uses unauthorized means of transmission, his acceptance is received within the time it would have been received with the use of the authorized means, the acceptance operates when received.[46] Thus, when an acceptance by mail is authorized, an acceptance by wire operates when it is received if it is received within the time that an acceptance sent by mail would have been received. Third, the rule does not apply when the telegram or letter is improperly sent.[47] To illustrate, when a letter is posted without a stamp or without a correct address, it does not constitute an acceptance.[48]

Termination of Offers Not Withdrawn. An unrevoked offer does not exist indefinitely. It may end in one of several ways,

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[44] *Western Union Telegraph Co.* v. *Wheeler*, 114 Okla. 161, 245 P. 39.
[45] *Elkhorn-Hazard Coal Co.* v. *Kentucky River Coal Corporation*, 20 F. (2d) 67.
[46] R., Sec. 68.
[47] R., Sec. 67.
[48] *Blake* v. *Hamberg, Bremen Fire Ins. Co.*, 67 Tex. 160, 2 S. W. 368.

and after the termination an assent thereto is ineffective as an acceptance.[49]

Time. An offer terminates at the expiration of a period specified in the terms of the offer during which an acceptance can be made. Thus, when an offer stipulates that the acceptance must be made on or before a specified day, the offer ends on that day and a subsequent acceptance will have no effect.[50] When no time is specified, the offer expires after the lapse of a reasonable time.[51] What constitutes a reasonable time depends upon the place, the season, the year, and the particular nature of the subject matter. For example, an offer to sell perishable goods will ordinarily lapse more quickly than one in which the subject matter of the offer is staple goods or land.

> A manufacturer of awnings and window shades, in October, offered to purchase advertising space for twenty-six weeks starting on the following March 1. The publisher accepted on February 10. It was held that the acceptance was not unreasonably delayed under the circumstances and that the offer had not lapsed. (Times Picayune Pub. Co. v. Harang, 10 La. A. 242, 120 S. 416)

Rejection. An offer is also terminated by a distinct refusal on the part of the offeree.[52] After a rejection, the offeree cannot later accept, unless the offeror renews the proposal.

> Several persons made an offer to guarantee payment of the price of goods purchased by A. I. Holmes. The creditor rejected the offer, but he subsequently attempted to accept the proposal. The offer lapsed upon rejection, and the offeree could not create a contract by a later acceptance. (J. R. Watkins Co. v. Stewart, 220 Ala. 43, 124 S. 86)

Counteroffer. A counteroffer will cause the offer to lapse, as it is in effect a rejection.[53] Thus, when an oil company sent an offer to purchase a heat exchanger, and the offeree accepted the offer upon condition that a third of the price be remitted

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[49] R., Sec. 35.
[50] *Herndon* v. *Armstrong*, 148 Oreg. 602, 38 P. (2d) 44.
[51] R., Sec. 40.
[52] R., Sec. 37.
[53] R., Sec. 38.

immediately to accompany the order, there was a counteroffer, and the original offer was no longer open to acceptance.[54] A counteroffer does not amount to a rejection, however, if a contrary intent is shown, as when the offeree indicates at the time of the counteroffer that he is still considering the offeror's proposal. The same is true when the offeror, upon making the offer, invites counterproposals.

An owner made an offer to sell a cottage under a deferred-payment plan, but he invited a cash proposal from the offeree. The offeree made a cash proposition which was refused. He then accepted the offer made by the owner. It was held that the counteroffer did not under the circumstances amount to a rejection of the offeror's proposal. (Quinn v. Feaheny, 252 Mich. 526, 233 N. W. 403)

Disability. If either the offeror or the offeree dies or becomes insane, the offer ordinarily terminates.[55] For example, an offer of guaranty, which the offeror may withdraw, terminates at the death of the offeror.[56]

Kurtz Brothers offered to buy back certain bonds they had sold to Samuel Achenbach, who died without having accepted the offer. The offer terminated upon the death of the offeree and could not be accepted by the administrator of his estate. (Achenbach v. Kurtz, 306 P. 284, 159 A. 718)

Illegality. If, after an offer is made but before there is an acceptance, the formation of the proposed agreement becomes illegal, the offer is terminated.[57] Thus an offer to lend money at eight per cent interest is terminated when, before acceptance, a statute is enacted prohibiting contracts calling for this rate of interest. In like manner, if, after an offer is made but before there is an acceptance, the performance of the proposed agreement becomes illegal, the offer comes to an end.

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[54] *Apex Engineering Co.* v. *North American Oil Consolidated,* 76 Calif. A. 683, 245 P. 766.
[55] R., Sec. 48.
[56] *American Chain Co.* v. *Arrow Grip Mfg. Co.,* 134 Misc. Rep. 321, 235 N. Y. S. 228.
[57] R., Sec. 50.

QUESTIONS

1. "An agreement requires a meeting of the minds." "An agreement requires an apparent meeting of the minds." Which statement is correct?

2. Hazlitt maintains that there is only one way is which an agreement may originate. Is his contention sound?

3. Thomas Connell offered to convey to P. G. Alston a six hundred acre tract of land situated in North Carolina, provided Alston paid to him the sum of $3,502 before the following first day of December. If Alston paid the money within the time specified, did the parties create a bilateral or a unilateral contract?

4. Edward F. Newton offered to sell to William Newton for the sum of $8,000 a certain tract of land situated in the city of Newport, Massachusetts. William Newton, for reasons of his own, did not care to accept the offer. His children, on the other hand, wished to purchase the property. Could the children accept the offer?

5. Rosebery wires an offer to Pellew. Upon receipt of the wire Pellew sends a letter of acceptance which is lost in transit. Rosebery, not hearing from Pellew, sells the goods which he had offered him to another party. Pellew sues for breach of contract. Is he entitled to judgment?

6. Fordham sends an offer of $1,000 for Carter's automobile. Carter sends Fordham an offer of the same car for $1,000. The letters cross en route. Is there an agreement?

7. Ramey sends an offer to pay Vane $100 if the latter will repair the roof of his house. The letter is not received by Vane. A few days later Vane repairs Ramey's house, because he thinks it needs repairing. After completing the work, he is told about the offer which he did not receive. Is there an agreement?

8. Mahan offers twenty dozen fresh country eggs at the market price to Innes. Two days later Innes accepts. Mahan refuses to deliver the eggs. Innes sues for breach of contract. Is he entitled to judgment?

9. Kyle makes an offer to Greiner. While Greiner is contemplating the matter, Kyle withdraws the offer. Greiner wishes to turn the offer into an agreement by an acceptance. May he do so?

10. Laprade writes Fortescue an offer of a trunk for $100. Fortescue replies, stating that he will give him $85 for the trunk. Not hearing from Laprade, he later writes that he accepts the offer of the trunk at $100. Laprade refuses to make delivery, and Fortescue sues for breach of contract. Is he entitled to judgment?

11. Rowles offered to sell his farm for $14,000 to Sharon, who paid Rowles $100 to keep the offer open for a period of two months. Sharon

accepted the offer one month later, but he found that Rowles had conveyed the property to another person. Was Rowles under any liability to Sharon?

12. Heenan sends an offer to Shay on Wednesday. On Thursday Heenan sends another letter withdrawing his offer. This letter is lost in the mail. Shay accepts the offer on Friday. Has an agreement been formed?

13. De Witt inserted in a newspaper an offer of reward for the arrest and the conviction of the person or persons who set fire to his store. Ennis saw the offer and started after the guilty party, who, according to rumor, had fled to South America. A month later De Witt inserted an advertisement in the newspaper withdrawing his offer. Not knowing that the offer had been withdrawn, Ennis captured the wrongdoer and brought him back to this country. Ennis' prisoner was convicted of setting fire to De Witt's store. Ennis now claims the reward. Is he entitled to it?

14. Groves sends an offer to Brady stating, "You may accept this offer by placing a lighted lantern in your window." Brady, intending to accept, places a lighted lantern in his window. Groves claims that there is no agreement because he did not have knowledge of the acceptance. Is his contention correct?

15. Reaves offers a reward of $100 to anyone finding and returning his lost dog. Tulley finds and, intending to accept, returns the dog. Reaves refuses to pay Tulley on the ground that Tulley is a stranger to whom no offer had been made. Is Reaves' action justifiable?

16. Albright sends an offer to Spencer who makes a mental determination to accept. Spencer maintains that an agreement is formed. Is his contention sound?

17. Marks writes to Reed stating, "I offer my radio for $100. If I do not hear from you within ten days, I'll consider the set sold to you." Reed, without intending to accept, does not reply. Marks sues Reed for breach of contract. Is he entitled to judgment?

18. Constable writes to Asquith offering ten cords of birchwood suitable for burning in a fireplace at $35 a cord. Asquith writes back stating that he will take eight cords. Is there an agreement?

19. Fotheringham writes to Lecky offering five tons of steel rails at a given price. He further states, "I am leaving for New York. If you wish to accept, send your reply to my office at Chicago." Lecky sends his acceptance to Fotheringham at New York. Is there an agreement?

20. Small sent an offer to Carter, who accepted. Before Carter accepted the offer, Small died. Was a contract formed?

21. Morley accepted an offer to engage in a prize fight. Before the acceptance was made, prize fights were declared illegal. Was a contract formed?

Part III—Genuineness of Assent

Real or Genuine Assent. It has been noted that the basis of the ordinary contract is agreement and that an agreement requires mutual consent, or, in other words, consists of an exchange of assents. In order for an agreement to be enforceable, however, it is essential that the consent of the parties be real or genuine. If there is no real or genuine assent, the agreement is defective and unenforceable. The unreality of consent may be due to one of several causes, namely, mistake, misrepresentation, fraud, duress, or undue influence.

Because of lack of real or genuine assent, these circumstances render an agreement defective, for they vitiate the apparent consent, either *ipso facto* or at the election of one or both parties. In the latter case the agreement is binding unless the party elects to avoid its obligations. In other words, the agreement is voidable, and not void. The difference is important in that when an agreement is merely voidable, the party having the right to avoid it may do so, as against third parties, only before such persons have acquired rights under the contract.

Mistake. A mistake consists of an act under the influence of an erroneous belief or ignorance in respect to the past or present existence of some fact. As a general rule one cannot escape from the obligations of an agreement by showing that he has made a mistake. Hence a unilateral mistake as to quality, value, or quantity, unless made a condition to the contract, usually does not affect the agreement. Nor will a mistake as to price, unknown to the other, ordinarily afford grounds for relief. As one is held to the knowledge of the laws of his own state, a mistake as to such laws will not invalidate the agreement.

> "It is a rule of almost universal application that a mistake of law, in the absence of fraud or undue influence, does not afford grounds for the abrogation or reformation of a contract." (Security Life Ins. Co. v. Leeper, 171 Ark. 77, 284 S. W. 12)

There are a few instances, however, in which a mistake will make consent unreal. In such cases the apparent exchange

of assents may not make an agreement which is merely voidable. There may in fact be no agreement. The transaction in such case will be therefore void.

Identity of Subject Matter. When there is a mutual mistake as to the identity of the subject matter, the agreement is void.[1] In other words, there is no agreement, for the parties have not assented to the same thing. For example, when one agrees to purchase wine from a particular estate in France, and there are two estates of that name, and the seller refers to one estate and the buyer means the other, there is no contract.[2] The estate each party had in mind must, however, be described by the terms of the agreement; otherwise it would be binding. If, then, there had been but one estate by that name, and the buyer had meant another, he would nevertheless have been bound, regardless of his mistake.

> After receiving quotations for two grades of potatoes, a buyer ordered a carload without specifying the grade but intending the cheaper grade. The seller accepted by shipping the better grade. No contract was formed. (Mutual Sales Agency v. Hori, 145 Wash. 236, 259 P. 712)

Existence of Subject Matter. When the subject matter of the agreement, unknown to the parties, does not exist at the time the agreement is made, there is no binding contract.[3] To illustrate, when a trust company made a contract with reference to a lot on which both parties believed a house had been built, whereas there was in fact no house built thereon, the contract was not binding.[4] In such cases there is an implied condition in the agreement that the subject matter exists. If the agreement is absolute and does not appear to be made with an implied condition that the subject matter exists, the nonexistence of the subject matter does not affect the agreement.

> "Where the parties purport to sell specific goods, and the goods without the knowledge of the seller have wholly perished at the time when the agreement is made, the agreement is void." (Uniform Sales Act, Sec. 7)

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[1] R., Sec. 71.
[2] *Raffles* v. *Wichelhaus*, 2 Hurl. and Colt. 906.
[3] R., Sec. 49.
[4] *Jeselsohn* v. *Park Trust Co.*, 241 Mass. 388, 135 N. E. 315.

Identity of Parties. When one party under a mistake as to the identity of the other party who is not present enters into an agreement, the transaction may be deemed void. For example, if Brown, a poor man, sends an offer for certain goods, and the seller accepts under the impression that the offeror is a certain rich man with the name of Brown, some courts hold that there is no agreement, on the ground that primary intent of the seller was to deal with the man he had in mind, and not with the sender of the offer. They hold, on the other hand, that there is an agreement, when the two parties are dealing face to face, and the seller intends to contract with the party before him, although mistaken as to the identity of such party.[5] Thus, in the illustration above, if Brown had personally made the offer, the seller by accepting would consent to the agreement with Brown, the poor man, even though the seller would not have done so had he known who Brown was. If under these circumstances the party misrepresents himself, the agreement should only be voidable on the ground of fraud.

> A buyer agreed to purchase certain goods through an agent who represented that he was acting for a corporation engaged in manufacturing such goods. The agent was in fact acting for an individual who was not a manufacturer. The buyer, who intended to deal with the corporation, was not bound on the agreement. (School Sisters of Notre Dame v. Kusnitt, 125 Md. 323, 93 A. 928)

Nature of the Transaction. When one enters into an agreement under a mistake as to the nature of the transaction, induced by misrepresentation or trickery and without negligence, there is no contract. For example, where an illiterate or blind person or one unfamiliar with the language is induced to sign a note which is represented to be a receipt or a lease, there is no contract.[6] In such cases the party did not intend to sign that instrument, and therefore he is not considered as having signed it.

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[5] *Ludwinskav* v. *John Hancock Mut. Life Ins. Co.*, 317 Pa. 577, 178 A. 28.

[6] *Eldorado Jewelry Co.* v. *Darnell*, 135 Iowa 555, 113 N. W. 344.

> The owner of a lot and store building agreed to lease the premises to one Navin. He read the lease carefully and signed what he believed were two copies of the lease. In fact, he signed a deed which, unknown to him, had been substituted for the duplicate copy of the lease. The deed was void. (McGuinn v. Tobey, 62 Mich. 252, 28 N. W. 818)

It is important, however, that the party be free from negligence. One is presumed to have read the terms of an agreement to which he places his signature. "A person cannot sign a paper in ignorance of its contents and thereafter excuse such ignorance by the mere plea that he was busy or that he is habitually neglectful in such circumstances, and throw upon the courts the burden of protecting him from the consequences of his imprudence." [7] Even an illiterate or blind person must exercise ordinary care and prudence in ascertaining the contents of an instrument which he signs, or he will be bound by its terms.

Misrepresentation. The validity of an agreement at early common law was not ordinarily affected by misrepresentation in the form of an innocent misstatement of facts. A few exceptions existed in cases in which the agreement was based upon trust and confidence. In this class of contracts are those made under circumstances in which one party is compelled to rely or is justified in relying upon the other for knowledge of the facts. Illustrations of agreements of this kind are insurance contracts, in which misrepresentation in the form of an innocent misstatement of a material fact will make the agreement voidable.[8] So, too, in cases of agreements between guardian and ward, or parent and child, a misrepresentation by the guardian or by the parent, although innocently made, will vitiate the consent of the other party to the agreement.[9]

Courts of equity have always allowed rescission by one party to an agreement when he was induced to enter the agreement by an innocent misstatement of a material fact by the other party. Modern courts of law have been inclined to follow courts of equity in giving this relief. Such decisions

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[7] *Standard Mfg. Co.* v. *Slot*, 121 Wis. 14, 98 N. W. 923.
[8] *Post*, p. 411.
[9] R., Sec. 476(b).

seem essentially fair and just and will probably be accepted generally in the future.[10]

> The notice of an auction sale of real estate, offered by the receivers of a corporation, innocently misrepresented the rentals. The buyer, who relied upon the truth of the representation, was allowed in equity to rescind the transaction. (In re New Jersey Refrigerating Co., 100 N. J. Eq. 537, 136 A. 179)

Misrepresentation may take the form of concealment. Ordinarily concealment does not affect the validity of an agreement, because one party to a bargain is not required to tell all he knows, even when he knows that the other party is ignorant of the facts. There are, however, a few instances in which concealment has the same effect as a material misrepresentation. Such instances occur when a trustee, an executor, an agent, an attorney, or a business adviser deals with a person who is entitled to believe or justifiably expects that his interests will be safeguarded.

Fraud. An agreement induced by fraud is voidable at the election of the injured party.[11] Fraud differs from misrepresentation in that there is knowledge of the falsity, that there is an intent to influence conduct, and that the fact represented need not be material. The elements of fraud will now be considered.

False Statement of Fact. There must be a representation as to a past or existing fact. A statement in respect to future conduct is no more than a promissory statement and is not usually a basis of this wrong. It is a basis of fraud, however, when it is a contractual promise made with the undisclosed intention of not performing the promise.[12]

> A. A. Janney promised to pay a certain sum for a lot, relying on a promise that valuable improvements were to be made in the vicinity of the lot. The promise, having been made with no intention at the time of fulfillment, constituted the basis of fraud. (Snell Nat. Bank of Winter Haven v. Janney, 219 Ala. 396, 122 S. 362)

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[10] R., Sec. 472.
[11] R., Sec. 476.
[12] R., Sec. 473.

Fraud may not be based on a statement of belief or opinion, except when the person who makes the statement does not have that which he claims to have, in which case he misrepresents his state of mind. A statement of value is usually treated as an opinion, except when made under circumstances so as to imply facts to justify the statement. "If the facts are not equally known to both sides, then a statement of opinion by the one who knows the facts best involves very often a statement of fact, for he impliedly states that he knows facts which justify his opinion." [13] A misrepresentation of the law may not ordinarily be the basis of fraud, because a statement of legal consequences of facts is generally only an opinion. It may be the basis of fraud, however, when it is made by one who is supposed to possess expert knowledge to one who is ignorant of the subject.[14]

> One of the most common exceptions to the rule that fraud may not be based upon misrepresentations of the law, arises "where the parties to the contract occupy confidential or fiduciary relations; another similarly arises where one who has had superior means of information possesses a knowledge of the law and thereby gains an unconscionable advantage over another." (Bank of America v. Sanchez, 3 Calif. A. [2d] 238, 38 P. [2d] 787)

It is often stated that the fact misrepresented must be material. This is sometimes due to a misunderstanding of fraud as a basis for avoiding an agreement and of actionable fraud, that is, fraud as a basis for an action in tort to recover damages, in which case the importance of the fact misrepresented must be considered. So far as avoidance is concerned, an unscrupulous person should not be allowed to hold another party to a bargain on the ground that such party was foolish to rely upon an unimportant fact, as judged by the opinion of a reasonable man.[15] Indeed, so far as allowing a person who has been deceived into entering into a bargain to withdraw therefrom is concerned, it would seem that any fact which is intended to induce action and does induce action is of

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[13] *MacDonald* v. *Smith*, 139 Mich. 211, 102 N. W. 668.
[14] R., Sec. 474(b).
[15] R., Sec. 471, Comm. (i).

importance and is a material fact. Thus, courts stating that the fact must be material may mean no more than that the misrepresented fact must have been relied upon by the other party.

Known to Be False. The one making the statement must know that it is false. One is considered, however, as having knowledge of the falsity in instances other than those in which there is a deliberate declaration of an untruth. For example, knowledge of falsity is presumed when the maker of the statement does not believe it to be true or when the statement is made recklessly, irrespective of whether it is true or false.[16]

> In a suit to rescind a contract for land on ground of fraud, the court declared that "a party selling property is presumed to know whether the representations he affirmatively makes in respect of it are true or false." (Borders v. Kattleman, 142 Ill. 96, 31 N. E. 19)

Intent to Influence. There must be an intent that the party to whom the statement is made should act thereon. Intent to injure is immaterial, but there must be an intent to influence conduct. For this reason, usually only the party to whom the statement is made may complain if he acts thereon. In some cases, however, where "a representation made to one person, with the intention that it shall reach the ears of another and be acted upon by him, and is acted upon by him to his injury, gives the person so acting upon it the same right to relief or redress as if it had been made to him directly." [17]

> The Ohio Shoe Company sold certain goods, relying upon a false financial statement furnished by the buyer to R. G. Dun & Co., an organization supplying credit ratings to its subscribers. This statement, though not made directly to the seller, will constitute the basis of fraud. (Manly v. Ohio Shoe Co., 25 F. [2d] 384)

Influencing Conduct. The statement must be relied upon by the party for whom it is intended. When there is no action arising from the statement because it is not believed or is known to be false, there is no liability as conduct has not been

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[16] *Shackett* v. *Bickford*, 74 N. H. 57, 65 A. 252.
[17] *Henry* v. *Dennis*, 95 Me. 24, 49 A. 58.

influenced. It is sometimes difficult to determine when one has been deceived, for persons vary largely in respect to vigilance and sagacity. It is no defense, however, that one is unusually credulous. Although, in general terms, the courts state that one is required to note obvious untruths, there is no duty to make an investigation to verify the statements. "Any different doctrine, carried to its logical conclusion, would facilitate transactions in gold bricks, salted mines, bogus diamonds as real, facsimiles as originals, and would permit a variety of things destructive to commercial integrity." [18]

> "When a party, ignorant of the real facts, and having no ready means of information, makes a purchase or enters into a transaction as to the subject matter of which representations have been made which are material, the law will presume, as a matter of fact, that he relied on them." (Hicks v. Stevens, 121 Ill. 186, 11 N. E. 241)

It is often stated that, in order to avoid an agreement for fraud, the party must have relied upon the misrepresentation to his damage. When "to his damage" is so used to indicate that the defrauded party must have suffered financial or other injury, it seems that again the concept of fraud as the basis for avoiding an agreement is confused with actionable fraud, that is, fraud as a basis for an action in tort to recover damages, in which case injury must have occurred. Of course, in some cases the phrase "to his damage" is used to mean no more than that the party acted upon the misrepresentation. The better rule seems to be that it is immaterial, so far as avoidance of an agreement for fraud is concerned, whether damage is caused.[19]

Duress. An agreement may be defective on the grounds of lack of real assent because of the existence of duress. The term *duress* means coercion by actual or threatened injury or restraint which is sufficient to prevent one from exercising his free will.[20] In such case there is no genuine consent, and the agreement, as in the case of fraud, may ordinarily be

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[18] *Crompton* v. *Beedle*, 83 Vt. 287, 75 A. 331.
[19] R., Sec. 476, Comm. (c).
[20] R., Sec. 492.

avoided.[21] In a few instances it is held that duress will render an agreement void rather than voidable. Duress renders an agreement void only when the person under compulsion "does not know or have reason to know the nature of the transaction to which he apparently manifests assent, or is a mere mechanical instrument without directing will in performing the acts apparently indicating assent." [22] For example, if a person is compelled to sign a note that he believes to be only a petition or if he is compelled while under hypnotic control to sign a note, such a note is void.

> William McCoy contended that a release of claims against his employer was absolutely void on the ground of duress. The court, apparently referring to a situation in which a person's hand is taken and forcibly guided, said: "Duress might be such as to render a settlement void at law. The actual application of force to compel the act of signing a release would constitute an instance." (McCoy v. James T. McMahan Const. Co. [Mo.], 216 S. W. 770)

The existence of duress is a question of fact which will depend in each case upon the particular circumstances. At an early date the common-law test of duress was whether the threats were of a nature sufficient to deprive a courageous man of his free will. This rule was later modified so that one was compelled only to offer resistance equal to the fortitude of an ordinary man. These tests looked to the means employed as the measure of duress, rather than the result. The general rule today, however, is that duress exists in any case, irrespective of the severity of the threats or violence, when the particular individual is actually prevented from exercising his free will. "In considering the matter of whether there is in fact restraint or coercion, the courts usually consider the state of the mental or physical health, the condition in life, the experience of the person, and his education and intelligence." [23]

Duress may be due to fear of actual or threatened wrongful or illegal imprisonment. It may also be caused by actual or threatened bodily harm. Actual violence or threats against a third person do not constitute duress, except in the case

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[21] R., Sec. 495.
[22] R., Sec. 494

of a member of one's family or other near relative.[24] At one time this excepted group was thought to consist only of relations such as parent, child, husband, and wife. Modern decisions, however, have enlarged this group. For example, duress may result from threats against more distant relations, such as brother, aunt, grandparent, or son-in-law.[25] Duress may also result from threats of injury to one's property when the circumstances are such that the threats prevent the exercise of a free will.

Undue Influence. The consent of one party to an agreement may be unreal because of undue influence, in which case the injured party may elect to avoid it.[26] "Undue influence is a kind of mental coercion, which destroys the free agency of one and constrains him to do that which is against his will, and which he would not have done if left to his own judgment and volition, so that his act becomes the act of the one exerting the influence, rather than his own act—such act being to his own injury, or to the injury of some one upon whom he would, if left to his own free will, have bestowed a benefit." [27]

> A woman made a contract with reference to her board, room, and care for life, in order to be among her friends and near her church. In denying a claim of undue influence, the court declared that "any reasonable influence obtained by acts of kindness or by appeals to the feelings or understanding but not destroying free agency is not undue influence." (Yankey v. Clark, 224 Ky. 346, 6 S. W. [2d] 274)

The test of the existence of undue influence is identical with duress, namely, whether one party has been prevented from exercising his free will. The difference is in the means employed. For this reason, undue influence is sometimes said to be a subtle form of duress. It is usually more difficult to establish, however, for the line of demarcation between undue influence and proper influence, argument, or persuasion

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[24] R., Sec. 493.
[25] *Foutain* v. *Bigham*, 235 Pa. 35, 84 A. 131.
[26] R., Sec. 497.
[27] *Beard* v. *Beard*, 173 Ky. 131, 190 S. W. 703.

is often difficult to determine. In some cases one may be greatly influenced by another, but, because of the parties and the circumstances, no valid claim of undue influence can be maintained. To illustrate, although the influence of a husband over his wife may be undue influence, the influence of the wife over her husband is much less likely to be considered undue influence.[28]

> "Honest intercession and persuasion is not undue influence; there must be 'unlawful importunity, on account of the manner or motive of its exertion.'" (Hawkes v. Mobley, 174 Ga. 481, 163 S. E. 494)

Under certain circumstances the law makes a presumption of undue influence, in which case the other party must prove its absence and the fairness of the transaction.[29] Circumstances which cause a presumption of undue influence are such as those in which one is peculiarly subjected to the influence of the other because of family relation, distress, mental weakness, or fiduciary relations. The rule is therefore applied between parent and child, guardian and ward, physician and patient, and attorney and client. The term *fiduciary relations* refers to any "relationship of blood, business, friendship, or association, in which the parties repose special trust and confidence in each other and are in a position to have and exercise, or do have and exercise, influence over each other." [30]

> Ola Bentson agreed to give certain property to F. D. Studley, in return for a home and care for life. Studley was a friend in whose integrity Bentson had confidence. It was held that this did not make "a confidential relation within the meaning of the doctrine as it is known to the law." (Johnson v. Studley, 80 Calif. A. 538, 252 P. 638)

It should be noted at this time that in cases of undue influence and in cases of duress,[31] as well as in cases of fraud, the power of the injured person to avoid an agreement may be lost. This loss of power to avoid such agreements occurs when the injured party, with knowledge, affirms the trans-

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[28] *Coleman* v. *Coleman*, 85 Oreg. 99, 166 P. 47.
[29] R., Sec. 498.
[30] *Curtis* v. *Armagast*, 158 Iowa 507, 138 N. W. 783.
[31] R., Sec. 499.

action,[32] when he uses the property received from the guilty party after an offer to return it is refused,[33] or when he fails within a reasonable time to notify the guilty party.[34] What is considered a reasonable time depends largely upon whether a delay would work to the benefit of the injured party and to the hardship of the guilty party, whether it would cause the other party to change his position materially, or whether it would prejudice a third person.

QUESTIONS

1. Hallgren finds a necklace of beads and exhibits them to Sidmouth. The latter, thinking they are worth $50, offers $25 to Hallgren for the strand. Hallgren accepts the offer and delivers the beads to Sidmouth. Later Sidmouth, upon discovering that the necklace is worth only $20, refuses to pay the agreed amount. Hallgren brings an action for the contract price. Is he entitled to judgment?

2. Johnston agrees to sell and Harrington agrees to buy goods which are to arrive on a ship called *Peeress*. There are two ships by that name due to arrive. Johnston has one in mind, and Harrington has the other in mind. When Harrington fails to receive the goods, he sues Johnston for breach of contract. Is he entitled to recover damages?

3. Cornell wrote to Neville, offering to sell his house and lot at 1125 Second Street in a given city for $7,450. Neville accepted the offer but had in mind Cornell's house and lot located on Second Avenue in the same city. When Neville refused to carry out the agreement, Cornell brought an action to recover damages. Was he entitled to judgment?

4. Lowell mails an offer to purchase Carney's piano, which he signs "B. C. Worthington." Carney, being acquainted with Worthington, accepts the offer. Is Lowell entitled to enforce the agreement?

5. Wasser represented himself to be George Blaine to Kline. As a result Kline entered into an agreement to sell certain furniture to Wasser on credit. When Kline refused to carry out the agreement, Wasser brought an action against Kline to recover damages. Was Wasser entitled to judgment?

6. Pelton signs all of the papers placed before him by his secretary. Among the papers is a contract of guaranty. When Pelton is sued on this agreement, his defense is that he did not read the contents before signing the instrument. Is this defense valid?

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[32] R., Sec. 484.
[33] R., Sec. 482.
[34] R., Sec. 483.

7. Schwartz, who could not read English, signed an instrument written in this language upon the representation that it was a lease. He really signed a promissory note. Schwartz was sued on the note. Was the holder of the note entitled to recover the amount?

8. Kimble sent an agreement to purchase shares in a corporation to Farris, stating that the paper was a petition for the removal of the mayor of the city. Farris, who was busy, signed the instrument without reading it. When Farris refused to accept and pay for the stock, Kimble brought an action to recover damages. Was he entitled to judgment?

9. Cobbett, without mentioning that his horse balks at bridges, offers to sell the animal to Welling for $500. The latter accepts the offer and immediately starts to drive the horse home. At the first bridge the horse refuses to go over, and Welling returns the horse to Cobbett stating that he will not pay for it. Cobbett brings an action for the price. Is he entitled to recover the agreed amount?

10. Anders executed a note to secure the purchase price of certain property situated in Aberdeen, Mississippi. Burner, the seller, induced the purchase by misrepresenting the location of Aberdeen, saying that it was situated at the head of navigation on the Tombigbee River. As a matter of fact, as Anders knew, the head of navigation on this river was twenty miles above Aberdeen. When sued on the note, Anders claimed fraud on the part of the seller. Was this claim sound?

11. John W. Brown conveyed certain land in Nebraska to Roswell G. Pierce by deed. Subsequently, Brown brought suit to avoid the agreement. He alleged that Pierce, accompanied by three other members of an unlawful association, the Omaha Claim Club, came to his home and threatened personal violence if he did not execute the deed. He further alleged that as the result of repeated threats by these men he executed the deed. Was Brown entitled to avoid the agreement?

12. Bagot is being sued for damages arising out of breach of contract. He alleges that the agreement was obtained by duress. What test will be used to determine the existence of duress? How does this test differ from the test employed by early courts?

13. It is said that undue influence is a subtle form of duress. What is meant by this statement?

14. A ward conveyed certain property to his guardian. The conveyance was later attacked upon the ground of undue influence. What burden did the guardian have in order to sustain the conveyance?

15. Frame by fraud induced Conroy to enter into a contract. Conroy discovered the fraud, and after the lapse of a reasonable time thereafter he sought to avoid the contract. Was he entitled to do so?

Part IV—Consideration

Necessity of Consideration. An agreement, although consisting of an exchange of genuine or real consents, is not necessarily enforceable. The law does not recognize, as a general rule, any executory agreement, unless the promise has been purchased or induced by something done or forborne.[1] In other words, society does not feel that the coercive arm of the law should apply to the enforcement of obligations arising from promises by which nothing has been gained by the promisor or lost by the promisee. For example, a mere promise to make a gift, although presumably creating a moral obligation, is not enforceable at law.[2] In determining whether a promise has been purchased, courts look to see whether that which is known as consideration has been bargained for or given in exchange for the promise.

> "It is elementary that every simple contract must be based upon some consideration." (Cooper & Griffin v. Bridwell, 177 S. C. 219, 181 S. E. 56)

The term *consideration* has been defined in various ways, none of which is entirely satisfactory. Thus it is said to be "something of value received by one party or parted with by the other by reason of the contract." [3] Again it is defined as "some legal right acquired by the promisor in consideration of his promise, or forborne by the promisee in consideration of such promise." [4] The definitions, although varying in phraseology, are in substantial concurrence that the promise must be induced by some benefit to the promisor or some detriment to the promisee. It therefore follows that the doctrine of consideration briefly stated is that a promise will be enforced only when it has been paid for or purchased.[5]

> "Motive and consideration are not interchangeable terms, since the motive for a promise does not supply the element of consideration. 13 C. J. 325, Sec. 165." (Martin v. Deaton, 44 Ga. A. 528, 162 S. E. 399)

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[1] R., Sec. 19(c).
[2] *In re Fisher's Estate*, 128 Oreg. 415, 274 P. 1098.
[3] *Grant* v. *Isett*, 81 Kans. 246, 105 P. 1021.
[4] *Thomas* v. *Mott*, 74 W. Va. 493, 82 S. E. 325.
[5] R., Sec. 75.

Consideration as defined is known as *valuable* consideration. *Good* consideration, although sometimes used interchangeably with valuable consideration, technically means love and affection existing between near relatives. As a general rule, good consideration is sufficient to make binding only executed agreements.[6] In some states, however, it will support an executory agreement.

Adequacy of Consideration. Inadequacy of consideration alone will not affect the validity of an agreement as a general rule.[7] In the absence of fraud, the mere fact that what is done or forborne is of trifling benefit to the promisor or of slight loss to the promisee is immaterial. Courts are not ordinarily concerned with the wisdom or folly exercised by parties in making contracts. The promisor therefore should, at the time of making the agreement, weigh carefully the factors which induce his promise. So long as the parties act fairly and lawfully, they are not precluded from making any contract they may desire. It is impossible for the courts to determine what value the promisor places upon the act performed or the promise of an act, which is requested or offered in exchange for his promise.

> A professional man promised to pay $140 in return for the publication of his name in a commercial list. The fact that the publishing of his name was not worth the sum promised did not prevent the performance requested from being sufficient consideration for his promise. (De Loach v. W. D. Eyre & Co., 46 Ga. A. 155, 167 S. E. 123)

Inadequacy of consideration in a few instances may affect the validity of the agreement. First, in some states by statute the consideration is required to be adequate. Second, when inadequacy is very great, so as to shock the conscience of the court, it will be treated as evidence of fraud. Third, the rule that inadequacy does not affect the validity of the agreement does not apply when there is an exchange of sums of money of the nation where the contract is made, or an exchange of amounts of goods of the same kind and quality, such as wheat

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[6] *Sapp* v. *Lifrand*, 44 Ariz. 321, 36 P. (2d) 794.
[7] R., Sec. 81.

or oil at the same time and place.[8] For example, where one person promised $600 in return for the promise of another to pay him one cent, the agreement was held to be unenforceable because of lack of consideration. The court stated, however, that "had the one cent mentioned been some particular one cent, a family piece, or ancient, remarkable coin, possessing an indeterminate value, extrinsic from its simple money value, a different view might be taken." [9]

Mutual Promises. Valuable consideration in some instances may consist of a promise to do or not to do an act.[10] In other words, a promise may be sufficient consideration to support another promise so as to make a valid contract. The promise, however, in order to constitute sufficient consideration, must be definite and certain, concurrent in time with the other, and legally and physically possible of performance; and it must impose a legal liability on the promisor.

Unless the promises are concurrent, neither is sufficient consideration for the other. For example, when one sells his business and later promises not to engage in the same business, the promise of the buyer in executing the sale at a previous time will not make the second promise of the seller binding.[11] In such case, the first promise was not requested, offered, or given in exchange for the second promise, hence it could not be the consideration or bargain price for the second promise.

> Max Ruby promised to pay $20,069.48 for a branch store of the Haverford Cycle Company. Ruby alleged a subsequent promise by the president of the company to reduce the amount of the purchase price. The promise to pay the purchase price was not a consideration for the alleged subsequent promise. (Sladkin v. Ruby, 103 N. J. L. 449, 135 A. 880)

A promise to do an act which is legally or physically impossible is not sufficient consideration. Physical impossibility does not mean improbability or that the promisor is unable

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[8] R., Sec. 76(c).
[9] *Schnell* v. *Nell*, 17 Ind. 29, 79 Am. Dec. 453.
[10] R., Sec. 75(d).
[11] *Kimbro* v. *Wells*, 112 Ark. 126, 165 S. W. 645.

to do the act. It means that the promise is obviously on its face impossible to do, as a promise to deliver coal or perform other acts at a time then past. The rule of physical impossibility has been applied ordinarily to promises where "the thing stipulated was, according to the state of knowledge of the day, so absurd that the parties could not be supposed to have so contracted." [12] Legal impossibility refers to acts not allowed by law, such as the transferring of a license which is by law nontransferable.

> "Where there is obvious physical impossibility or legal impossibility which is apparent on the face of the contract, the latter is void." (Jacksonville M. P. R. & Nav. Co. v. Hooper, 160 U. S. 514, 40 L. Ed. 515)

The promise, in order to constitute consideration, must also impose a liability upon the promisor.[13] As the promise of a married woman at common law was void, it was therefore not a valid consideration. On the other hand, a voidable promise is sufficient. For example, an oral promise which is unenforceable under the Statute of Frauds is generally held to be a valid consideration; and the same is true in case of a promise of an infant.[14] Although the law does not require mutuality of remedy, it does require that there be mutuality of engagement. If one party has made no engagement to perform, as when under the agreement he has an option to perform or not as he sees fit, the other is not bound by his promise. Suppose one company promises to sell another at a given price all the coal it may order, and the latter promises to pay the price for all the coal it may order. There is no contract, as there is no mutuality of engagement.[15] Suppose, however, that the offer is to supply at a given price all the coal which the offeree may need or require for a specified period, and this offer is accepted. Although there are decisions to the contrary, most courts hold this to be a valid contract on the ground that there is a mutual engagement, although the liability may be contingent. Thus in one case the court stated:

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[12] *Clifford* v. *Watts*, L. R. 5 C. P. 577.
[13] R., Sec. 80.
[14] R., Sec. 84(e).
[15] R., Sec. 79.

"It cannot be said that the appellant was not bound by the contract. It had no right to purchase coal elsewhere for use in its business." [16]

Voluntary Subscriptions. When public enterprises are based upon voluntary subscriptions by a number of persons, the promises are generally enforceable. For example, when one among others promises a specified sum for an enterprise of a church, a charitable institution, or a college, the subscription is binding.[17] The grounds for sustaining such promises, however, vary with the different courts. One view is that the promise of each subscriber is consideration for the promises of the others. In many instances, however, this is not sound, as the promises are not given in exchange for each other. Another view is that the liability of the promisor rests upon an equitable estoppel because obligations have been incurred in reliance upon the promise. Other courts treat a subscription as an offer for an act which is accepted by the creating of liabilities or making of expenditures. Under this theory the promise is revocable until the act is performed. It is also held by some courts that the acceptance of a subscription carries an implied promise creating an obligation to perform in accordance with the offer. Thus it has been said that "the general trend of judicial decision may therefore be said to be in the direction of sustaining contracts for subscriptions or donations to churches or charitable or kindred institutions, where the same have been duly accepted, their acceptance constituting a good consideration, for the reason that obligations are thereby assumed." [18]

Forbearance. The forbearance to act or the waiving or giving up of a right, legal or equitable, may constitute valuable consideration for the promise of another.[19] For example, the relinquishment of a right in property, of a right to sue

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[16] *Minnesota Lumber Co.* v. *Whitebreast Coal Co.*, 160 Ill. 85, 43 N. E. 774.

[17] *Board of Home Missions, etc.* v. *Manley*, 129 Calif. A. 541, 19 P. (2d) 21.

[18] *Presbyterian Bd. of Foreign Missions* v. *Smith*, 209 Pa. 361, 58 A. 689.

[19] R., Sec. 75.

for damages, of homestead rights, of dower rights, or of any right in general secured by contract, will be sufficient to support a promise given in return for it.[20] In such cases, however, the forbearance must be in respect to acts which one may legally do or which are not contrary to public welfare.

L. Horvath asserted that his forbearance to sue under a Workmen's Compensation Law constituted consideration for a promise of his employer. It was held that since Horvath under the statute could not legally surrender his right to sue, there was no consideration for the promise. (Horvath v. Sheridan-Wyoming Coal Co., 58 Wyo. 211, 131 P. [2d] 315)

When the refraining from doing an act in return for a promise will make the latter enforceable, a promise to forbear to exercise such right will also constitute valuable consideration. In either case the right may be against a third person or his property, as well as against the promisor or his property.

It was asserted that in exchange for the promise of a man to pay for a necklace, a company promised to forbear suing the man's wife. It was held that a promise to forbear suing a third person, if for a period of time no matter how brief, constitutes sufficient consideration. (Tiffany & Co. v. Spreckles, 202 Calif. 778, 262 P. 742)

Mere forbearance will not constitute a consideration. There must be a forbearance or a promise to forbear in return for the promise of the other. The length of time of forbearance is immaterial; it may be one day or one year. When no time is stated, a reasonable time is implied. There must, however, be an obligation to forbear for a definite or reasonable time. To illustrate, when one promises to forbear as long as he wishes, there is not a valid consideration for the promise of the other, as he is not under an obligation to forbear but can act at once if he desires.[21]

Forbearance as consideration most frequently appears in case of compromises. This involves a forbearance to sue in return for a promise in respect to a disputed claim. At one

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[20] *Kvello* v. *Taylor*, 5 N. Dak. 76, 63 N. W. 889.
[21] *Strong* v. *Sheffield*, 144 N. Y. 392, 39 N. E. 330.

time it was believed that the forbearance had to be in respect to a valid claim, but it is now well settled in most states that unsoundness of the claim alone does not affect the case. It is agreed by all courts that the one forbearing or promising to forbear must believe his claim. Thus, when one refrains from bringing suit on a claim which he knows is unenforceable, such forbearance will not support a promise.[22] Whether his belief must be reasonable is a question on which courts differ. Many courts hold that the validity of the claim must be reasonably doubtful.[23] On the other hand, the weight of authority seems to be that the unreasonableness of the claim is immaterial, so long as the promisor honestly believes it.

Promising to Perform Existing Obligations. A promise to do or the doing of what one is already under legal obligation to do is ordinarily not valid consideration.[24] This rule is based on the theory that in such instances the promisee receives nothing for his promise. For example, a promise to pay a certain sum to a police officer for making an arrest in the line of duty is unenforceable on account of lack of consideration.[25] If the act requested is over and beyond the call of duty, the performance of such act by the officer or other person will make the promise binding.

> A man promised $5,000 in return for his wife staying with him and taking care of things as she always had done. It was held that since the wife did no more than she was under a legal duty to do, there was no consideration for the promise. (Frame v. Frame, 120 Tex. 61, 36 S. W. [2d] 152)

The act done or promised may also be one which the promisor is already under an obligation by contract to perform.[26] Thus, when a contractor refuses to complete a building unless the employer promises him an additional bonus of $1,000, and the sum is promised, the question arises whether the promise of the employer is binding. A few courts hold af-

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[22] *Taylor* v. *Weeks*, 129 Mich. 233, 88 N. W. 466.
[23] R., Sec. 76(a).
[24] R., Sec. 84(c).
[25] *Hammer* v. *Wells Fargo & Co. Express*, 174 App. Div. 724, 160 N. Y. S. 651.
[26] R., Sec. 84(d).

firmatively on the theory that there is a mutual rescission of the first contract by a substitution of another. Some other courts take the same view as to the enforceability of the second agreement, but on the theory that the contractor has given up his right of election to perform the contract or abandon it and pay damages. Most courts, however, hold that the second promise of the employer is without consideration. They criticize severely the reasoning of the courts holding contrary, and they denounce the equity of their decisions because of the coercive power it provides a wrongdoer. Thus one court said: "The doctrine of these cases as it is frequently applied does not commend itself either to our judgment or our sense of justice, for where the refusal to perform and the promise to pay extra compensation for performance of the contract are one transaction, and there are no exceptional circumstances making it equitable that an increased compensation should be demanded and paid, no amount of astute reasoning can change the plain fact that the party who refuses to perform, and thereby coerces a promise from the other party to the contract to pay him an increased compensation for doing that which he is legally bound to do, takes an unjustifiable advantage of the necessities of the other party." [27]

> A manufacturer was bound by a contract to make and deliver a die for $2,000 to F. Joseph Lamb & Company. Thereafter the buyer promised to pay an additional $1,200 in return for the performance of the contract by the manufacturer. There was no consideration for the subsequent promise. (Siewek v. F. Joseph Lamb & Co., 257 Mich. 670, 241 N. W. 807)

The courts holding that there is no consideration for the second promise make an exception under extraordinary circumstances caused by unforeseen difficulties or mistakes. They do so usually upon the theory that the first contract was discharged because of an implied condition that the facts would be or would continue to be as supposed by the parties.[28]

In all cases in which the promise of the contractor is to do something that is neither expressly nor impliedly a part of the

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[27] *King* v. *Duluth, etc., Ry. Co.*, 61 Minn. 482, 63 N. W. 1105.

[28] Generally speaking, however, unanticipated difficulty or expense does not affect the liabilities of the parties. R., Sec. 467.

first contract, then the promise of the employer is binding. For example, if the bonus of $1,000 was promised in return for the promise of the contractor to complete the building at a date earlier than specified in the original agreement, the promise of the employer to pay the additional amount would be binding.[29]

The rule that doing or promising to do what one is already bound to do also generally applies to part payment made in satisfaction of debt. For example, if one person owes another $100, the promise of the latter to take $50 in full payment will not prevent him from collecting the remainder later.[30] This rule has been severely criticized, and in some instances it has been changed by statute or by court decision. Some courts treat the transaction as a binding gift of the remainder on the part of the creditor. The other courts, feeling that the rule is unjust, seize the slightest opportunity to find some new consideration, such as payment before the amount is due or the giving of security. If the debtor gives some article, even of slight value, in additon to the part payment, the agreement is held to be binding.

> A debtor gave his note for $8,000 and a mortgage on certain property to secure payment thereof, in return for the promise of his creditor to release the remainder of an unsecured debt of $9,922.20. There was sufficient consideration for the promise of the creditor. (Post v. First Nat. Bank, 138 Ill. 559, 28 N. E. 978)

In case of composition of creditors, when they agree to accept a fractional part of their claim in satisfaction thereof, their promises are binding. This is sometimes said to be an exception to the general rule that part payment is not valid consideration for a promise to discharge the debt. It may be argued, however, that there is new consideration. Thus it is stated that "the consideration for such an agreement is the mutual promise of the several creditors to take from their debtor something less or different than they were entitled to under their previous contracts with him." [31] Again it has been suggested that the debtor gives new consideration in procur-

[29] *Brownill* v. *Lowe*, 117 Ind. 420, 20 N. E. 301.
[30] *Willis* v. *Gammill*, 67 Mo. 730, 20 S. W. 301.
[31] *Schroeder* v. *Pissis*, 128 Calif. 209, 60 P. 758.

ing the other creditors' promises to forbear. Whether or not there exists a new consideration, the promises of the creditors are held to be binding.[32]

"Past" Consideration. Strictly speaking, there is no such thing as past consideration. In some instances it will be found that the promisee has previously performed or refrained from doing some act which was beneficial to the promisor. Such acts or forbearance in the past, although beneficial to the promisor, will not support a promise given later. For example, when one person performs some service for another without the latter's knowledge or understanding that compensation is to be received, a promise made later to pay for such services is unenforceable.[33] The forbearance of exercising a right or the performance of an act at a time previous to the promise is really no consideration at all; it is called past consideration but it will not support a promise. It must be borne in mind, however, that if an act is performed at the request of another, a promise on the part of the latter is binding, unless it was understood at the time that the services were gratuitous. In such cases the liability is based upon the theory that a promise is implied from the request.

> "If a man does a heroic act and is a mere volunteer, he cannot recover; nor can a subsequent promise to pay him be the basis of a recovery," but if "there is a prior request, and then after the services are rendered there follows the subsequent promise, under all the laws of contract of which we have knowledge, there is laid a perfect basis for a right to recover." (State v. Lusk, 37 Ohio A. 109, 174 N. E. 142)

There are a few exceptions to the rule that acts or forbearances will not support subsequent promises. It is held by some courts that when benefits are derived by fraud or under other circumstances which create a moral obligation, such constitute valid consideration.[34] One of the most outstanding exceptions is that which exists when one promises to pay a debt which is barred by infancy, by the Statute of Limitations,[35] or by an adjudication of bankruptcy.[36] Such promises

[32] R., Sec. 84(b).
[33] *Stoneburner* v. *Motley*, 95 Va. 784, 30 S. E. 364.
[34] R., Sec. 89.
[35] R., Sec. 86.
[36] R., Sec. 87.

are binding upon the theory that no consideration is necessary,[37] that the new promise is a waiver of the bar to action, or that the new promise is supported by the moral obligation to pay the old debt. The last theory makes the case an exception to the rule that past benefits or moral obligations constitute no consideration, but it seems to be the theory best supported by authority. Thus it is stated: "When a debt has been discharged by proceedings in insolvency, or has become barred by the statute of limitations, the remedy to enforce the payment of the debt is gone, but the moral obligation to pay it still remains, and is a good consideration for a new promise to make such payment." [38]

"Failure" of Consideration.[39] Consideration may take the form of an act or a forbearance, or of a promise to act or to forbear. When the act or forbearance is offered for and accepted by a promise, or is performed as an acceptance to an offer requesting such act or forbearance, the consideration is said to be executed. When there is an exchange of mutual promises, the consideration is said to be executory.

In case of an executed consideration, there can be no question of failure of consideration. The thing desired has been secured in the form of an act performed, a forbearance, or value given. If the act or forbearance turns out to be of less value than expected, or the thing given diminishes in value, it cannot affect the agreement. For example, if one promises to pay for an advertising card in a directory, the fact that the advertisement proves to be of no value to him, so far as bringing new business, does not impeach the sufficiency of the consideration, since the promisor receives what he requested for his promise.[40]

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[37] This view is adopted by the Restatement. See Sec. 85.

[38] *Lambert* v. *Schmalz*, 118 Calif. 33, 50 P. 13.

[39] If, in case of bilateral contracts, the consideration bargained for by each party was deemed to be the promise and the performance by the other, then failure to perform could properly be deemed to be a failure or partial failure of consideration. Since, however, the promise of each party is deemed to be a consideration for the promise of the other, it seems more appropriate to treat nonperformance by one party either as a condition precedent to duty of performance by the other party or as a discharge of such duty.

[40] *Mertins* v. *Hubbell Pub. Co.*, 190 Ala. 311, 67 S. 275.

A company executed an assignment of its right to a certificate of convenience and necessity for a bus line in return for a promise to pay $5,000. The fact that certificates were issued to others to operate over the same route, making the certificate of less value to the promisor, did not constitute failure of consideration. (Inter City Auto Stage Co. v. Bothell Bus Co., 139 Wash. 674, 247 P. 1040)

Likewise, in the case of an executory consideration, there can be no failure of consideration in a strict sense. If one does not get what he bargains for, there is no consideration at all; but if he does, then there is. Thus, when one accepts the promise of another in return for his promise, he gets his purchase price, irrespective of whether the promise is fulfilled; consequently there is no failure of consideration.[41] If, however, the promise is not fulfilled, this fact may be a good defense to an action by the other promisor, on the ground that performance is a condition precedent to duty of performance on the part of the promisee [42] or is a discharge of the promisee's duty of performance.[43] Some courts, in sustaining such defense, apparently announce what seems to be an erroneous theory of failure of consideration. If a substantial part of the promise is performed, a failure in respect to the remainder ordinarily does not release the other party. In some cases, a partial failure has been held to give a defense to that extent, and by statute in some states it affords grounds for rescission.

When Not Necessary.[44] At common law a consideration is not necessary as a general rule to support a promise under seal. Thus a gratuitous promise is enforceable when it is in the form of a sealed instrument.[45] This is true even though the parties admit the absence of a consideration. Although it is sometimes stated that a seal imports a consideration, a promise under seal was enforced because of its form alone long before the doctrine of consideration originated. "It de-

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[41] *Hurlburt* v. *Kephart*, 59 Colo. 353, 115 P. 521.
[42] R., Sec. 266.
[43] R., Sec. 274.
[44] The Restatement places in this group promises to pay debts whose collection is barred by the Statute of Limitations or by a bankruptcy proceedings, which were discussed in the preceding section.
[45] *Lodi* v. *Goyette*, 219 Mass. 72, 106 N. E. 601.

rives its efficacy from the solemnity of its execution—the acts of sealing and delivery—not upon the idea that a seal imports a consideration, but because it is his solemn act and deed, and is therefore obligatory. No consideration being necessary to give validity to a deed, it follows that the law does not from the fact of execution make an inference one way or the other in reference to a consideration." [46] In equity, however, the courts, although in general recognizing the doctrine of common law in respect to a seal, will not give the aid of their peculiar powers in many instances where there is in fact no consideration for a promise under seal.

> Specific performance will be denied when a contract is binding merely by virtue of being under seal, or in writing, or of having a nominal consideration, "unless some performance constituting a fair exchange is a condition of the defendant's duty." (Restatement, Contracts, Sec. 366)

The common-law rule that a promise under seal needs no consideration to support it has been abolished or modified by statutes in many states.[47] In a few states a sealed instrument is treated the same as an unsealed instrument and can be defeated by showing the lack of consideration. In other states when the promise is under seal, there is a prima facie presumption of consideration which may be rebutted.

No consideration is necessary to support obligations known as contracts of record, such as judgments and recognizances. They, like sealed instruments, are enforceable because of their form. Furthermore, no consideration is required to support a promise to do an act required by statutory law of the promisor.

> Agreements made by attorneys representing adverse parties to a proceeding in court, with reference to such proceeding, "are not deprived a legal operation because of lack of consideration." (Restatement, Contracts, Sec. 94)

When a negotiable instrument has been issued, there is a prima facie presumption of consideration, which, however,

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[46] *Walker* v. *Walker*, 35 N. C. 335.

[47] The Restatement has, however, retained the common-law rule that a promise under seal needs no consideration to make it operative as a sealed contract. Sec. 110.

may be rebutted as between the immediate parties. In some states by statute the same rule applies to all simple agreements which have been reduced to writing. In the case of negotiable instruments, however, lack of consideration is no defense after they come into the hands of holders in due course.[48] In other words, a promise in the form of a negotiable instrument is enforceable by a holder in due course or by one taking under him although there was in fact no consideration given for the promise.

> "Every negotiable instrument is deemed *prima facie* to have been issued for a valuable consideration." "Absence or failure of consideration is matter of defense as against any person not a holder in due course." (Uniform Negotiable Instruments Law, Secs. 24 and 28)

Some courts have enforced promises made without a consideration upon the theory of promissory estoppel. Under this theory one who makes a promise to another who acts upon it is precluded from setting up lack of consideration to avoid liability on the promise. This enforcement is proper, according to the Restatement, when the promisor should reasonably expect to induce and does induce action or forbearance of a definite and substantial character on the part of the promisee, and when "injustice can be avoided only by enforcement of the promise." [49]

Under statutes in some states no consideration is necessary in order to make certain promises in writing enforceable. The Uniform Written Obligations Act provides that "no release (or promise) hereafter made and signed by the person releasing (or promising) shall be invalid or unenforceable for lack of consideration, if the writing also contains an express statement, in any form of language, that the signer intends to be legally bound." [50]

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[48] *Post*, p. 343.
[49] Sec. 90.
[50] Sec. 1.

QUESTIONS

1. Temperley and Bright are discussing the enforceability of promises. The former maintains that all promises are enforceable. Do you agree with him?

2. Marks agreed to construct a one-car garage for Sanders, who agreed to pay Marks the sum of $75. Marks refused to perform, and Sanders promised him $115 for the construction of a two-car garage. When the building was completed, Sanders refused to pay Marks more than $75. Was Marks entitled to $115?

3. The American Refining Company and W. A. Morris entered into an agreement whereby the company agreed to sell all the oil Morris might need in his business during the ensuing year at a specified price. When the company failed to perform as agreed, Morris brought an action to recover damages. Was he entitled to judgment?

4. Camden promised to pay $100 to Barker. The promise was made in return for an old note, executed by James Brown and payable to the Woodstock National Bank, which was not enforceable. When sued by Barker, Camden contended that he was not bound by his promise because of the difference between the value of his promise and the value of the note given as consideration. Was this contention sound?

5. Brundage promises to pay $50 to Conybeare in return for the latter's promise to give him a five-cent piece of United States money. Later Brundage refuses to perform. He maintains that his promise is not enforceable. Conybeare sues for damages. Is he entitled to judgment?

6. Moser promises to repair Hill's tractor in return for the promise by the latter to pay him $25. Is there a consideration for the promise of either? Explain.

7. Plumb promises to shovel the snow from Sawyer's walk within the period of one hour, but he later finds that he cannot accomplish the task within that time. Is Plumb's promise within the rule that a promise to be sufficient consideration must be physically possible?

8. Adams promises Pierce to buy at a given price all the flour which he may desire to order during the next year, and Pierce promises to sell at that price all the flour ordered. When Pierce fails to perform, Adams sues him for breach of contract. Is he entitled to judgment?

9. Bosworth gratuitously promises Bender $100 in the form of a negotiable instrument. Bender sues on the instrument. Is he entitled to recover the amount of the note?

10. Pratt was one of many voluntary subscribers to a fund for the construction of a civic fountain as a monument to be dedicated to the soldiers from that city who were killed in a war. When the amount of his subscription became due, Pratt refused to make payment. He maintained that his promise was not enforceable. Was his contention sound?

11. Kegris promises to refrain from striking Avery in return for the latter's promise to give him $5. Is Avery's promise enforceable?

12. Bracken promises to act as surety for McGill's obligations in return for the creditor's promise to forbear suing McGill until he (the creditor) is ready to do so. The creditor sues to enforce Bracken's promise. May he do so?

13. Cutter claims that Hughes owes him $1,000. Hughes denies the claim and promises Cutter $800 in return for his promise not to bring an action. Cutter sues Hughes for the amount promised. What will be the decision if (a) Cutter knew his claim for $1,000 was false? (b) the claim was not reasonably doubtful?

14. Sauer promises a recorder of deeds $50 in exchange for recording a deed which he presents. Is Sauer's promise enforceable?

15. Blair promises to perform an act in return for five shares of stock. The shares of stock depreciate in value. Blair claims that he is not bound because there is a failure of consideration. Is his contention sound?

16. Merlin states that there is a failure of consideration in the case of an exchange of promises and the failure of one to perform. Is he correct?

17. Hewlett executes a promise in writing under seal to make a cedar chest for Weichman. Upon Hewlett's failure to perform, Weichman sues for breach of contract. Hewlett offers evidence to prove that there was no consideration for his promise. Is this evidence admissible?

18. Vorden agrees to accept $50 in satisfaction of Hoerner's note for $100 which is not due. Later Vorden sues Hoerner for the balance. Vorden maintains that there is no consideration given for his promise. Is his contention sound?

19. The creditors of Tierney sign an agreement that they will accept fifty cents on the dollar in satisfaction of their claims. Later one of them sues Tierney for the balance of the debt. The latter's defense is the promise by the creditors to accept fifty cents on the dollar. Is this a valid defense?

20. Dalmas, knowing that the trees in Seward's yard should be trimmed, proceeds to cut off all of the dead branches. When he tells Seward of the task which he performed, the latter promises to pay him $5 for doing the work. Is Seward's promise enforceable?

Part V—Legality of Bargain

Illegal Agreements. The formation or the performance of an agreement may be illegal. This is true when, under the common law or under statutes, either the formation or the performance of an agreement is criminal, tortious, or otherwise opposed to public policy.

> "As a general rule, the validity of a contract is determined by the law of the jurisdiction where made, and if legal there is generally enforceable anywhere. There is, however, a well-established exception to the rule to the effect that a court will not enforce a contract though valid where made if its enforcement is contrary to the policy of the forum." (F. A. Strauss & Co. v. Canadian Pac. Ry. Co., 254 N. Y. 407, 173 N. E. 564)

The effect of an illegal agreement is in general to render the agreement void. Courts as a general rule leave the parties in the situation they have created. If the agreement is executory, neither can enforce it. On the other hand, if it is executed, neither can seek relief in the courts.[1] The rule that courts will not aid parties to an illegal agreement is subject, however, to some exceptions. When the law which the purpose of the agreement violates is for the protection of one of the parties, that party may seek relief. For example, when in order to protect the public the law forbids the issuing of securities or notes by certain corporations, one who has purchased them may recover his money.[2] When the parties are not equally guilty, or, as it is said, are not in *pari delicto,* the one less guilty is granted relief when public interest is advanced by so doing.[3] Examples of circumstances to which this rule is applied are illegal agreements which are induced by undue influence, duress, or fraud.[4] Another exception exists in most states when a consideration has been paid for an illegal act which has not been performed.[5] Thus, when one under an agreement placed money with a stakeholder for the purpose of

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[1] R., Sec. 598.
[2] *Thomas* v. *City of Richmond,* 79 U. S. 349, 20 L. Ed. 453.
[3] R., Sec. 604.
[4] *Hess* v. *Culver,* 77 Mich. 598, 43 N. W. 994.
[5] R., Sec. 605.

swindling another by a pretended race, he was allowed to recover when he repudiated the agreement and requested his money before the race was run.[6]

> When a refusal to enforce or to rescind an illegal bargain would be injurious to parties for whose protection the law making the bargain illegal was enacted, "enforcement or rescission, whichever is appropriated, is allowed." (Restatement, Contracts, Sec. 601)

An agreement sometimes involves the performance of several promises, some of which are illegal and some, legal. In such case the legal part of the agreement may be enforced, provided it can be separated from the part which is illegal. The same rule applies when the consideration is illegal in part. The general rule is therefore: first, when there is an agreement consisting of several distinct promises, some of which are illegal, supported by a valid consideration, the good promises are enforceable; and, second, when several distinct promises are supported by several distinct considerations, the promises supported by valid considerations may be enforced.[7] To illustrate, when an agreement is made whereby a wife makes a promise with respect to her interests in her husband's estate, a promise relating to the custody of a child, and a promise to pay a sum of money, and there is a separate consideration for each promise, the fact that the consideration for the third promise is illegal does not render the other promises unenforceable.[8] These rules are not applied, however, to situations in which the illegal act or consideration is of such nature that it is said to taint the entire agreement.

> A promise to indemnify for losses and a promise to rebate part of the premium were made in exchange for a promise to pay a certain premium. The rebate of a premium violated a penal statute. Denying recovery of the promised premium, the court declared: "The agreement to pay the premium was founded upon the illegal promise to rebate a part thereof, and is tainted with the same illegality." (Sturm v. Truby, 245 App. Div. 357, 282 N. Y. S. 433)

When there is an indivisible promise to do several acts, some of which are illegal, the agreement is entirely void. So

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[6] *Falkenberg* v. *Allen*, 18 Okla. 210, 90 P. 415.
[7] R., Sec. 607.
[8] *Edleson* v. *Edleson*, 179 Ky. 300, 200 S. W. 625.

also when there is a single promise to do a legal act, supported by several considerations, some of which are illegal, the agreement cannot be enforced. For example, an agreement whereby a wife releases her interests in her husband's estate in return for several considerations, one of which is illegal, is void.[9]

Crimes and Civil Wrongs. An agreement is illegal and void when its object is the commission of any act which constitutes a crime or an indictable offense at common law or by statute.[10] To illustrate, one cannot enforce an agreement whereby one party is to assault another, to steal his goods, to burn his dwelling place, to print an obscene picture or libelous article, or to kill a person.[11]

> A mother brought an action for breach of an unconditional agreement to return her daughter to her upon the daughter attaining majority. The court declared such agreement to be void because its performance would unlawfully infringe the personal liberty of an adult person. (Dittrich v. Gobey, 119 Calif. 599, 51 P. 962)

An agreement which contemplates the commission of a civil wrong against third persons is also illegal and void.[12] Examples are agreements to injure the goods of another, to slander a third person, to defraud another, or to infringe another's patent, trade-mark, or copyright. Thus, a contract to buy an automobile, intended to defraud the finance company holding a mortgage on the car, is illegal and unenforceable.[13] A common example of agreements involving a civil wrong is an assignment or conveyance of property for the purpose of defrauding creditors. Another is the attempt of one party to palm off the skill or reputation of another so as to mislead buyers of goods. Thus an agreement for the use of the name of a skilled musician is illegal as a fraud upon the public if, when used, it gives a false idea as to the popularity of the vendor's goods.[14]

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[9] *In re Shannon's Estate*, 289 Pa. 280, 137 A. 251.
[10] R., Sec. 512.
[11] *Hoggard* v. *Dickerson*, 180 Mo. A. 70, 165 S. W. 1135.
[12] R., Secs. 571 to 579 inclusive.
[13] *Jackson* v. *Bryant*, 33 Ohio A. 468, 169 N. E. 825.
[14] *Krul* v. *Frank Holton & Co.*, 217 Wis. 628, 259 N. W. 898

Injuring Public Service. Any agreement which tends to interfere with the proper performance of the duties of a public officer, legislative, administrative, or judicial, is contrary to public policy and void.[15] Thus an agreement to procure by corrupt means a public contract is not enforceable.[16] Other instances are agreements to sell public offices, to procure pardons by corrupt means, or to pay a public officer more or less than the legal fees or salary.

> A city engineer made an agreement to accept less compensation than the amount duly fixed by law as his salary. The agreement was held to be contrary to public policy and void. (Peterson v. City of Parsons, 139 Kans. 701, 33 P. [2d] 715)

One of the most common agreements within this class is known as a *lobbying contract.* This term is ordinarily used to designate an agreement whereby one agrees to use bribery or other improper means to procure or prevent action by the national, state, or municipal legislatures. Such agreements are clearly contrary to the public interest; hence they are illegal and void. Some courts hold that all agreements to influence legislation, irrespective of the means employed, are void. Other courts adopt what appears to be the better rule, that such agreements are valid in the absence of the use of improper influence. Thus one court states that "any person interested in any proposed legislation before any legislative body may legally employ an agent or an attorney to collect facts relating thereto and to prepare a bill for the contemplated legislation, and such agent or attorney may explain the desired measure to the legislative body or any committee thereof fairly and openly, and have it introduced, and a contract to pay for such services, so rendered, violates no principle of law or of public policy."[17]

Usury. At common law there was no limit to the amount of interest which could be exacted for the loan of money. Most states, however, now have statutes prohibiting the tak-

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[15] R., Secs. 559 to 570 inclusive.
[16] *Whalen* v. *Harrison,* 26 Mont. 316, 67 P. 934.
[17] *Hyland* v. *Oregon Hassam Power Co.,* 74 Oreg. 1, 143 P. 920.

STATES	MAXIMUM SMALL-LOAN INTEREST RATES ALLOWABLE
Alabama	8% a year
Arizona	3½% a month
Arkansas	10% a year (same as usury law)
California	2½% a month on first $100, 2% on all above
Colorado	3½% a month on first $150, 2½% on all above
Connecticut	3% a month on first $100, 2% on all above
Delaware	8% discount on original loan including fees
Florida	3½% a month
Georgia	1½% a month
Idaho	3% a month
Illinois	3% a month on first $150, 2½% on all above
Indiana	3% a month on first $150, 1½% on all above; plus 50¢ fee
Iowa	3% a month on first $150, 2% on all above
Kansas	No law
Kentucky	3½% a month on first $150, 2½% on all above
Louisiana	3½% a month on first $150, 2½% on all above
Maine	3% a month on first $150, 2½% on all above; 25¢ minimum charge
Maryland	3% a month
Massachusetts	3% a month on first $150, 2½% on all above on unsecured loans
Michigan	3% a month on first $100, 2½% on all above
Minnesota	3% a month
Mississippi	10% a year
Missouri	3% a month on first $100, 2½% on all above
Montana	No law
Nebraska	3% a month to $150; 2½% to $300; ¾ of 1% to $1,000
Nevada	3½% a month on first $100, 3% on all above; $5 minimum; other charges
New Hampshire	2% a month; fee of $1 on loans up to $50, $2 on larger loans up to $300
New Jersey	2½% a month
New Mexico	10% a year; fee of 1/10 of loan; other charges
New York	3% a month on first $150, 2½% on all above
North Carolina	No law
North Dakota	No law
Ohio	3% a month to $150; 2% to $300; 2/3 of 1% to $1,000
Oklahoma	10% a year, plus fees
Oregon	3% a month; $1 minimum charge
Pennsylvania	3% a month on first $150, 2½% on all above; 6% a year after 18 months
Rhode Island	3% a month
South Carolina	No law
South Dakota	No law
Tennessee	6% a year; fee not to exceed 1% a month
Texas	10% a year (same as usury law)
Utah	3% a month
Vermont	2½% a month on first $125, 2¼% on all above
Virginia	2% a month
Washington	3% a month to $300; 1% to $500; $1 minimum charge
West Virginia	3½% a month on first $150, 2½% on all above
Wisconsin	2½% a month on first $100, 2% on second $100, 1% on all above $200
Wyoming	10% a year
District of Columbia	1% a month

Maximum Small-Loan Interest Rates

ing of more than the prescribed rate of interest.[18] These statutes, enacted to protect persons in want from the oppression of unscrupulous money lenders, provide a legal rate [19] and a maximum rate. When there is an agreement for interest, but no rate is specified, the legal rate is applied. The legal rate may also be recovered in cases enumerated in the provisions of the statute. The maximum rate is the highest rate that can be exacted under the law of a given state; it usually is recoverable only when there is an agreement for that amount in writing. Frequently the statutes permit small-loan associations, pawnbrokers, and similar businesses to exact a higher rate than is permissible in ordinary business transactions.[20]

> Small-loan laws have been enacted in the following states: Alabama, Arizona, California, Colorado, Connecticut, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Nebraska, New Hampshire, New Jersey, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Vermont, Virginia, West Virginia, Wisconsin.

The taking of a greater rate of interest than is allowed by law is known as *usury*.[21] In order to constitute a usurious transaction, there must be, first, an express or implied loan of money; second, an understanding that the money is to be repaid unconditionally; and, third, a payment of or an agreement to pay a greater rate of interest than is permitted by the statute. All of these elements must be present. Thus, where the rate of interest allowed is six per cent, and "five thousand dollars were paid for a ground (annuity) rent of five hundred dollars per annum," it is held that "this circumstance, although ten per cent be received on the money paid, does not make the contract unlawful." [22]

[18] R., Topic 4, Introduction.

[19] The word "legal" is not used here as the antithesis of "illegal." It means the rate that the law gives when no rate has been fixed by agreement.

[20] R., Sec. 526(c), special note.

[21] R., Secs. 526 to 537 inclusive.

[22] *Lloyd* v. *Scott*, 29 U. S. 204, 7 L. Ed. 833.

The effect of an agreement violating the usury laws differs in the various states.[23] In some states the entire interest is forfeited. In other states the recovery of the excess only is denied. In still other states the agreement is held to be void.

The following table shows the legal rate of interest and the rate allowed by special contract in the various states, the District of Columbia, Alaska, Hawaii, and Porto Rico.[24]

States and Territories	Legal Rate Per Cent	Contract Rate Per Cent	States and Territories	Legal Rate Per Cent	Contract Rate Per Cent
Alabama	6	8	Montana	6	10
Alaska	6	10	Nebraska	6	9
Arizona	6	8	Nevada	7	12
Arkansas	6	10	New Hampshire	6	Any rate
California	7	12	New Jersey	6	6
Colorado	6	Any rate [25]	New Mexico	6	10 [26]
Connecticut	6	12	New York	6	6
Delaware	6	6	North Carolina	6	6
D. of Columbia	6	8	North Dakota	4	7
Florida	8	10	Ohio	6	8
Georgia	7	8	Oklahoma	6	10
Hawaii	6	12	Oregon	6	10
Idaho	6	8	Pennsylvania	6	6
Illinois	5	7	Porto Rico	6	9 [27]
Indiana	6	8	Rhode Island	6	30
Iowa	5	7	South Carolina	6	7
Kansas	6	10	South Dakota	6	8
Kentucky	6	6	Tennessee	6	6
Louisiana	5	8	Texas	6	10
Maine	6	Any rate	Utah	6	10
Maryland	6	6	Vermont	6	6
Massachusetts	6	Any rate	Virginia	6	6
Michigan	5	7	Washington	6	12
Minnesota	6	8	West Virginia	6	6
Mississippi	6	8	Wisconsin	6	10
Missouri	6	8	Wyoming	7	10

Table of Interest Rates

[23] R., Sec. 526(c), special note.

[24] It should be remembered that the rates given above are for illustrative purposes only and that they may be changed at any session of the legislature. When exact information is desired, the statutes of the state should be consulted or the advice of a lawyer should be sought.

[25] When any rate is permitted for contracts, there usually is a limit for a small loan of approximately $300 or less, although this limit may be as high as three per cent a month.

[26] When a loan is unsecured by collateral, the contract rate may be twelve per cent.

[27] When the amount is more than $3,000, the maximum contract rate is eight per cent.

Obstructing Legal Processes. Any agreement tending to obstruct or pervert legal processes is contrary to public interest and is void.[28] Hence an agreement to pay a witness more than his regular fees, or more or less depending upon whether there is a favorable verdict, is void. "It is well settled that a contract to pay a witness for testifying where the payment is made contingent upon the success of the litigation is against public policy, since such a contract offers an inducement to perjury and tends to prevent the administration of justice." [29]

> A losing candidate for sheriff contested the election. He agreed to appoint another person deputy sheriff in return for testimony in the contest suit, provided he was successful in the proceedings. The agreement was held to be contrary to public policy and void. (Burchell v. Ledford, 226 Ky. 155, 10 S. W. [2d] 622)

Other examples of agreements of this class are those to stifle prosecution of a criminal case, to suppress evidence either in a criminal or in a civil action, to incite or foster litigation, or to work a fraud upon a court. So, also, an agreement containing stipulations which expressly or in effect oust the courts of their jurisdiction is void. To illustrate, an agreement that an action for the breach of an agreement shall be brought in a German superior court is not binding.[30] This rule has been applied to contracts which provide that all disputes shall be settled by arbitrators. There is a tendency, however, on the part of the courts, and by statutes, to permit the parties to select their own agents for adjusting their differences. Courts have generally enforced agreements which make arbitration of certain facts a condition precedent to the right to bring an action on the contract.

Wagers. At early common law practically all wagers were at first held to be valid and enforceable. Later courts made exceptions, declaring wagers to be illegal when they were contrary to good morals, tended to cause a violation of the law, or were likely to cause an injury to third persons. To-

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[28] R., Secs. 540 to 558 inclusive.
[29] *Pelky* v. *Hodge*, 112 Calif. A. 424, 296 P. 908.
[30] *Sudbury* v. *Ambi Verwaltung, etc.*, 213 App. Div. 98, 210 N. Y. S. 164.

day a wager is illegal and void under statutes prohibiting gambling transactions.[31]

> Lotteries possess the objectionable characteristics of wagers and are usually prohibited by statutes. (Restatement, Contracts, Sec. 520, Comm. b)

An insurance contract is not a wager and is legal and valid, because the party has an interest to protect and is merely transferring the risk of loss to one engaged in the business of risk-bearing. If, however, one purports to insure property or lives in which he has no interest, the agreement is purely a gambling transaction and is illegal.[32]

> "It is generally agreed that mere wager policies, that is, policies in which the insured party has no interest whatever in the matter insured, but only an interest in its loss or destruction, are void as against public policy." (Connecticut Mutual Life Ins. Co. v. Schaefer, 94 U. S. 457, 24 L. Ed. 251)

When there is an agreement for the sale of grain, stock, or other articles, and the parties do not intend delivery but agree that one shall pay the difference between the sale and the market prices at a given time, the transaction is a gambling one and is illegal.[33] If, however, the parties intend delivery, the agreement is valid, even though actual delivery is not made. Nor does the selling or buying on margin itself render the agreement illegal.[34] "A man may buy any commodity, stock included, to sell on an expected fall, and it will not be gambling. Margin is nothing but security, and a man may buy on credit, with or without security, or on borrowed money, and the money may be borrowed from his broker as well as from a third person. The test is: Did he intend to buy, or only to settle on differences? If he had bought and paid for his stock, held it for a year and then sold, no one would call it gambling; and yet it would be just as little so, if he had the stock but for an hour and sold before he had in fact paid for it. And so with selling. Every merchant who sells you some-

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[31] R., Sec. 520.
[32] *Post*, p. 405.
[33] R., Sec. 523.
[34] R., Sec. 522.

thing not yet in his stock which he undertakes to get for you, is selling 'short,' but he is not gambling, because, though delivery is to be in the future, the sale is present and actual." [35]

Sunday Laws. At common law an agreement could be executed legally on any day of the week. Today, however, most states have statutes which prohibit to some extent, at least, the making or the performance of agreements on Sunday.[36] These statutes, varying in terms and phraseology, must be examined separately in order to determine what agreements are prohibited. They may expressly declare agreements void if made on Sunday, prohibit only servile work or labor, prohibit "worldly employment," or prohibit labor or business of one's "ordinary calling." Under a provision of the last type, for example, one could legally enter into an agreement or do work outside of his usual calling.[37] On the other hand, contracts calling for performance on Sunday of that which is prohibited are ordinarily deemed void. Thus, under a statute prohibiting labor on Sunday, a contract for the exhibition of a flying circus on Sunday is unenforceable.[38]

> A statute prohibited the pursuit of ordinary callings on Sunday. It was held that the statute did not invalidate a check made and delivered on Sunday in payment for repairs on an automobile made in the working days of the week. (Maxton Auto Co. v. Rudd, 176 N. C. 497, 97 S. E. 477)

Sunday laws expressly provide that they do not apply to works of charity or necessity.[39] It is sometimes difficult, however, to determine what acts come within these exceptions, particularly in respect to the latter. Acts of charity include such as are involved in religious worship or in aiding persons in distress. What constitutes a work of necessity will vary according to the circumstances of a particular case, but in general it is an act which must be done at that time in order to be effective in saving life, health, or property.

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[35] *In re Taylor & Co.'s Estate*, 192 Pa. 304, 43 A. 973.
[36] R., Topic 5, Introduction.
[37] *Cook* v. *Blair*, 44 Ga. A. 691, 162 S. E. 658.
[38] *Ewing* v. *Halsey*, 127 Kans. 86, 272 P. 187.
[39] The Restatement expressly exempts also agreements to marry. Sec. 538.

An agreement negotiated on Sunday but made on a secular day is binding. Thus, when an offer is made on Sunday but the acceptance is not given until the next day, the agreement is valid because in law it is made on a week day.[40] If an agreement is made on Sunday, some courts hold that it can be ratified on a secular day. Other courts, however, hold to the contrary on the grounds that an illegal act cannot be ratified.[41]

Prohibited Callings or Dealings. Statutes frequently require a license, certificate, or diploma as a condition precedent to the right to engage in the practice of a particular profession, as in the case of a physician or lawyer, or to carry on a particular business or trade, as in the case of a real estate broker, peddler, stockbroker, innkeeper, or pawnbroker. If the requirement is for the purpose of protecting the public from dealing with incompetent or unreliable parties, an agreement by one in that business or profession who has not met the requirement of the law is void. Thus a contract with an unlicensed physician for services cannot be enforced.[42] On the other hand, if the license is imposed merely as a revenue measure, the agreement made in violation thereof is generally held valid.[43]

> An ordinance prohibited any person engaging in the business of real estate broker without having obtained a license. It was held that one engaged in negotiating the sale of real estate in violation of such ordinance could not recover commissions for his services. (Buckley v. Humason, 50 Minn. 195, 52 N. W. 385)

Dealings in certain commodities are also frequently regulated by statutes. Certain articles must be inspected, approved, and labeled before being offered to the public. It may also be required that the dealer have his measures and scales inspected, approved, and sealed by a designated official. Sales made in violation of such regulations are void, as these requirements are imposed as a protection to the public. Thus,

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[40] *Lawrence* v. *Farwell*, 86 N. H. 59, 163 A. 115.
[41] R., Sec. 539.
[42] *Whitehead* v. *Coker*, 16 Ala. A. 165, 76 S. 484.
[43] R., Sec. 580.

when a statute requires that packages of fertilizer bear tags stating the official analysis thereof, a sale or an agreement to sell in violation of such requirement is void.[44] When the statute merely imposes a penalty for doing an act, but does not prohibit the act or declare it illegal, it is generally held that the act is void. Some courts, however, carefully examine the terms of the legislation and its object, and they sustain the agreement unless it clearly appears that the legislature intended contracts in violation of the statute to be void.

> "When the object of the statute or ordinance in imposing a license to conduct a harmless and legitimate business is solely for the purpose of yielding a public revenue, and not for the purpose of protection, contracts made in the course of such business are valid, notwithstanding a penalty is imposed for a failure to obtain a license to conduct it." (Wood v. Krepps, 168 Calif. 382, 143 P. 691)

Dealings which involve the distribution of property by chance among the purchasers of such chances are known as lotteries and are prohibited by statutes. Such schemes are held to be illegal, although called gifts, guessing contests, raffles, or any other name, when they are in fact nothing more than a lottery.

In Restraint of Trade. An agreement in unreasonable restraint of trade is illegal and void on the ground of public policy.[45] Such agreements may take one of many forms, such as a corner of the market, a combination to create a monopoly, or an association of merchants to enhance prices.[46]

> A grower agreed that, if he raised and sold any loganberries, he would sell them to a co-operative marketing association. In view of the legislation fostering such associations, agreements of this kind, unless clearly unreasonable, are today held to be valid. (Oregon Growers' Co-op. Ass'n v. Lentz, 107 Oreg. 561, 212 P. 811)

A common form of agreements of this kind is one which restrains one from exercising his trade or carrying on his

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[44] *Vanmeter* v. *Spurrier*, 94 Ky. 22, 21 S. W. 337.
[45] R., Sec. 514.
[46] R., Sec. 515.

business. In early times the least restraint would render the agreement void. The reasons assigned were: (1) Such agreements "injure the parties making them, because they diminish their means of procuring a livelihood and a competency for their families. They tempt improvident persons for the sake of present gain to deprive themselves of the power to make future acquisitions, and they expose such persons to imposition and oppression. (2) They tend to deprive the public of the services of men in the employments and capacities in which they may be most useful to the community as well as to themselves. (3) They discourage industry and enterprise, and diminish the products of ingenuity and skill. (4) They prevent competition and enhance prices. (5) They expose the public to all the evils of monopoly." [47]

> Federal statutes, as well as state laws, are directed against agreements which unreasonably restrain trade. (Sherman Act, 15 USCA, Secs. 1-7; Clayton Act, 15 USCA, Secs. 12-27; Federal Trade Commission Act, 15 USCA, Secs. 41-51)

At a later date, agreements of this nature were classed in accordance with the extent of their limitation. There were four groups: namely, where the restraint was, first, unlimited as to time and space; second, limited as to time but unlimited as to space; third, unlimited as to time but limited as to space; and, fourth, limited as to both time and space. Agreements within the first two classes were considered illegal and void. Modern courts, however, have been inclined to disregard the preceding classification as a means to determine the validity of such agreements. They realize that it is unjust to allow the seller of a business to engage in competition which will naturally result in keeping that which he has sold, and in fairness to the buyer some restraint should be permitted.[48] The same is true when one partner buys the interest of the other.[49] The courts also recognize the importance of business and professional men employing and instructing assistants, but that "they would naturally be reluctant to do so

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[47] *Alger* v. *Thacher*, 19 Pick. (Mass.) 51.
[48] R., Sec. 516(a).
[49] R., Sec. 516(d).

unless such assistants were able to bind themselves not to set up a rival business in the vicinity after learning the details and secrets of the business of their employers." [50] The tendency of modern decisions has therefore been to hold such restraint reasonable if it is necessary under the particular circumstances to protect the goodwill of the covenantee.[51]

> An employee, who was to be trained by his employer in tree surgery, agreed that within a year after the employment ended, he would not enter the services of a competing company within a radius of one hundred miles from any city in which the employer had an office. It was held that the agreement was valid. (Davey Tree Expert Co. v. Back, 137 Misc. Rep. 702, 244 N. Y. S. 239)

In recent times the validity of agreements restricting the resale price of commodities has become a very important question. As a general rule such contracts have been held illegal in this country. When the restriction is reasonable, however, there are strong arguments in favor of a contrary rule which has been adopted in a few states. It is quite possible that a reasonable restraint of this kind may be more beneficial than injurious to the public. Justice Holmes of the Supreme Court, in a dissenting opinion, stated: "I cannot believe that in the long run the public will profit by this court permitting knaves to cut reasonable prices for some ulterior purpose of their own and thus to impair, if not to destroy, the production and sale of articles which it is assumed to be desirable that the public should be able to get." [52] It seems that the agreement fixing the resale price of an article should be sustained when such agreement is necessary to protect the producer and is not unfair to the public.

The view of Mr. Justice Holmes has recently been adopted in the fair-trade laws of forty-two states. In these states, legislation expressly allows price-maintenance agreements. In other words, such legislation permits an agreement between a seller of trade-marked or branded goods and a buyer of those goods to the effect that the buyer will not sell the goods for less than a specified price.

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[50] *United States* v. *Addyston Pipe, etc., Co.*, 85 F. 271.
[51] R., Sec. 516(f).
[52] *Miles Medical Co.* v. *Park, etc., Co.*, 220 U. S. 373, 55 L. Ed. 502.

QUESTIONS

1. During the trial of an action a question arose as to whether an agreement is valid if the object of the agreement is not expressly prohibited by a statute. What is your opinion?

2. The legislature of the state of New York enacted a statute prohibiting banks from issuing a certain type of note. One bank issued notes of this kind to W. H. Warbell. Warbell later brought an action to recover the money he had paid to the bank. Was he entitled to judgment?

3. Sells purchased some wild game in violation of a statute prohibiting such sales. An hour later he returned what he had purchased. Could he expect the aid of a court to obtain a return of the purchase price?

4. Ballew purchased from Nagle certain drugs in varying amounts at specified prices. Two of these drugs were sold illegally. Ballew gave Nagle a promissory note for an amount equalling the sum of the purchase prices. Could Nagle enforce payment of the note?

5. Carpenter gives $100 in return for Iber's promise to blackmail Lundstrom. Before Iber performs his promise, Carpenter repents and sues to recover the money paid. Is he entitled to judgment?

6. Munson agrees to sell Bentley an automobile for $1,000 and a machine gun for $400. There is a statute prohibiting the sale of machine guns. What are Bentley's rights if Munson fails to carry out his promises?

7. N. B. Morris built a house on two acres of land in Henry County, Kentucky. He rented the property to William Jackson, who agreed to pay as rent a sum of money that amounted to ten per cent of the cost price of the property. In an action by Morris against Jackson it was contended that the agreement violated the usury statute of the state, which did not permit the collection of ten per cent interest. Was this contention sound?

8. The terms of an agreement provide that Fairchild is to pay Snedaker $100 for a banjo and $1,000 for destroying Stickney's airplane. Snedaker sues Fairchild for the price of the banjo. Is the latter liable for the amount?

9. Meadows sold his grocery store to Cantwell and agreed not to enter into the retail grocery business at any time within a distance of one mile from the present location of his store. After the lapse of a period of six months, Meadows opened a grocery store located within a distance of a half mile from the old store. Cantwell brought an action against Meadows to recover damages arising out of breach of contract. Was Cantwell entitled to judgment?

10. Dumont promises to pay $5,000 to Lebrecht if the latter appears before a senate committee and argues the merit of certain proposed legislation in which Dumont is interested. The bill is enacted, and Dumont refuses to pay the amount promised. In an action for damages brought by Lebrecht against Dumont, the latter disclaims liability on the ground that the agreement is illegal. Is Dumont's defense valid?

11. Hardelein executes a note for $1,000 and interest, payable to Nowland one year from date. In this state the legal rate is six per cent and the maximum rate is eight per cent. How much is Nowland entitled to collect when the note matures?

12. Lowitz, a retail merchant, entered into an agreement with Medinger, a manufacturer, not to sell the latter's products for less than a given price. Medinger sued Lowitz for breach of contract. Lowitz contended that the agreement was illegal. Was his defense valid?

13. Gebhardt promises to pay $500 to Perkins if he will destroy evidence needed in a criminal action against Gebhardt. Perkins destroys the evidence and sues Gebhardt for the amount promised. Is he entitled to judgment?

14. Lowden promises to build a house for Young. They also agree that neither shall have a right of action on the contract until any dispute has been referred to arbitrators and they have made an award. Young claims that Lowden has failed to perform and sues him for breach of contract without waiting for an arbitration and an award. Does Lowden have a valid defense?

15. Perlow agrees to buy a certain quantity of wheat from Boyden. Their agreement also provides that if the price of wheat is higher on the tenth of July, Boyden will pay Perlow the difference in the prices, and, if lower, Perlow will pay Boyden the difference. Perlow sues Boyden for breach of contract. Is he entitled to judgment?

16. A question arises in a trial of a case as to the validity of an agreement to buy stock. It is maintained that the agreement is unenforceable on the ground of illegality. What test is used to determine whether an agreement of this kind is illegal?

17. A statute prohibits business or labor of one's ordinary calling on Sunday. Prentice, a barber, agrees to repair Cull's radio set on Sunday. Cull sues Prentice for breach of contract. Is the latter liable for damages?

18. A statute requires real estate brokers to secure a license. Parron, without securing a license, engages in the business of buying and selling real estate for others. He is now suing a vendor to recover a fee for his services. Is he entitled to judgment?

19. Berien sells to Tillotson a ton of coal which he weighs on scales which have not been inspected and approved by the proper officer as required by law. Berien sues Tillotson for the purchase price. May he recover the amount?

Part VI—Competent Parties

Capacity to Act.[1] A legal agreement, consisting of an exchange of real or genuine assents and based upon sufficient consideration, is not necessarily an enforceable agreement or, in other words, it may not be in all respects a valid contract. In addition to the requirement of certain essential elements pertaining to the agreement itself, there are certain extrinsic factors which must be taken into account.

The law, in ascertaining the validity of an agreement, looks beyond the agreement itself in one respect, namely, the capacity of the parties. In order that an agreement may be enforced, the parties thereto must have the capacity to make binding promises. Certain parties may in the eyes of the law lack the capacity to act, in which case any agreement by such parties will be defective to that extent.

Persons held to be unable to act for themselves may be under a legal or a natural incapacity. The latter exists when the incapacity is due to some natural disability, as in the case of an idiot, lunatic, or an immature infant. Legal incapacity is merely the result of a rule of law, as in the case of married women at common law, aliens, convicts, or, in some instances, infants who are near majority. Incapacity to act, however, does not necessarily preclude the capacity for legal rights.

Infants. The most important group of persons under a disability consists of infants. At common law any person, male or female, under twenty-one years of age is known as an *infant* or a *minor*. In some states there are statutory modifications of this rule particularly in respect to females. For example, in some states a female becomes of age at eighteen or upon marriage; and in one state at least, a male obtains majority upon marriage.[2] In some states a minor may be allowed by courts or by statutes to make certain binding contracts.

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[1] The competency of parties to enter into a binding agreement is not discussed in the Restatement of the Law of Contracts. See Sec. 431, Comment (a).

[2] *Iowa Code*, 1931, §10492.

The Civil Code of Georgia declares: "If a minor, by permission of his parent or guardian, or by permission of law, practices any profession or trade, or engages in any business as an adult, he shall be bound by all contracts connected with such trade, profession, or business." (Wickham v. Torley, 136 Ga. 594, 71 S. E. 881)

At common law one ceases to be an infant on the day before the date of majority, that is, the twenty-first birthday, because the law does not ordinarily recognize fractions of the day. The theory is that an infant attains majority the last second of the day preceding the twenty-first birthday and is therefore of age all of that day.

"It is our opinion that the statute of this state changes the common law, and a minor becomes of full age on the first minute of the anniversary of his birth." (Bynum v. Moore, 101 Okla. 128, 223 P. 687) See, also, statutes changing the common law in California, North Dakota, and South Dakota.

The effect of an agreement entered into by an infant varies; hence his agreements may be classified as enforceable agreements, void agreements, and voidable agreements.

Enforceable Agreements. There are certain instances when the agreement of an infant is binding and enforceable against him. First, he is bound on contracts which the law authorizes, as an enlistment in the military forces or an execution of a statutory bond. Second, an infant is bound on contracts the performance of which the law would compel him to do anyway. Thus, when an infant holds title to land for his father under an agreement that the land shall be used to pay the father's debts, and in pursuance to such agreement he conveys the land to another person, the conveyance is binding.[3] In the cases given above the obligation is really imposed by law rather than by agreement.

An infant was required by law to give a bond as security for the support of his child. He was not allowed to avoid the agreement on the ground of infancy. (Township of Borden v. Wallace, 50 N. J. L. 13, 11 A. 267)

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[3] *Hlawaty* v. *Zeok*, 253 Pa. 311, 98 A. 557.

It is sometimes said that an infant is bound by contracts for necessaries. This, however, is inaccurate. He is liable only for the reasonable value of such necessaries, not the agreed price, and only if he has been supplied with the necessaries. It is a quasi-contractual liability, or an obligation imposed by law. This rule is adopted in order to encourage the provision of necessaries which otherwise might be denied the infant.

> "'It is, however, inaccurate, strictly speaking, to say that an infant's contract, if for necessaries, is valid and binding upon him. The more accurate statement is that he is liable to pay the reasonable value of such necessaries as he has purchased or received; or as it is sometimes expressed, he is liable on an implied contract, but not on the express contract which he has made.'" (Plummer v. Northern Pac. Ry. Co., 98 Wash. 67, 167 P. 73)

Whether goods furnished an infant are necessaries depends upon their nature, quality, and quantity. The term *necessaries* ordinarily refers to food, lodging, and things relating to health, education, and comfort, according to the infant's station in life. What is a necessary for one person may not be a necessary for another. To illustrate, a high-school education may be necessary for one infant, and a professional or college education may be necessary in case of another, depending upon the financial and social status.[4] Things concerning an infant's property are not ordinarily classed as necessaries. The same rule is applied in case of ornaments and things used for pleasure only. Money is not ordinarily considered a necessary, even though spent for things within that class, except when the lender sees that he buys such things. In the latter case, the infant is answerable for the money the same as if the necessaries had been directly furnished by the lender. One modern case, however, has held that money lent for necessaries to an infant of twenty years can be recovered even though the lender does not see that the money is so spent.[5]

Even though the things supplied are within the class of necessaries, they will not be deemed necessaries if the infant

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[4] *Moskow* v. *Marshall*, 271 Mass. 302, 171 N. E. 477.
[5] *Norwood Nat. Bank* v. *Allston*, 152 S. C. 199, 149 S. E. 593.

is being supplied elsewhere or if the quantity furnished is too large. The same is true when the things are of a too expensive quality.

> A minor purchased on credit certain clothing from the plaintiffs. He was allowed to avoid liability. "The plaintiffs were not entitled to recover on the theory that this account was for necessaries furnished, because the evidence was undisputed that all necessaries for the minor were furnished by his father." (Pearson v. White, 13 Ga. A. 117, 78 S. E. 864)

Void Agreements. At one time courts held that the agreement of an infant was void when it was clearly prejudicial to his interests. This rule was unsatisfactory because it threw a burden upon the court to decide in each case whether the agreement was prejudicial to the infant. Later, courts generally held that an agreement of an infant was merely voidable on the ground of incapacity, except in the case of an appointment of an agent or attorney. There seems to be no valid reason for making this exception, and there is a tendency to eliminate it. Thus one court stated that "notwithstanding numerous general statements in the books to the contrary, we feel at liberty to hold, in accordance with what we deem sound principle, that the powers of attorney were not absolutely void because of plaintiff's infancy, but merely voidable." [6]

> "The better reasoning supports the rule that no contract of an infant is void because of nonage, but all such contracts are voidable only." (Shroyer v. Pittenger, 31 Ind. A. 158, 67 N. E. 475)

Voidable Agreements. Except as previously noted, the agreements of an infant may be avoided at his election. This privilege is personal, however, and can be exercised only by the infant himself or by his personal representative if the infant dies. Third parties cannot exercise the privilege for him, nor can the other party to the agreement avoid it on that ground, unless he is also under a disability.

An executory agreement may ordinarily be avoided by an infant at any time, either before or after becoming of age.

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[6] *Coursolle* v. *Weyerhauser*, 69 Minn. 328, 72 N. W. 697.

The same rule is applied in case of executed agreements with two exceptions. First, a conveyance of land cannot be avoided by an infant until he reaches his majority. In such a case, however, he may enter the land and take the profits until the time when he can avoid the agreement. Second, an agreement in respect to either real or personal property cannot be avoided after the lapse of a reasonable period of time after majority.

> Certain personal property and land were transferred to a minor in return for his promise to do certain things. When sued for breach of contract ten years after he had attained majority, the minor was not allowed to avoid the agreement, on the ground that he had failed to disaffirm within a reasonable time after becoming of age. (Krbel v. Krbel, 84 Nebr. 160, 120 N. W. 935)

Voidable agreements, in the absence of statute, are binding upon the infant when he has ratified an executory agreement at or after majority or when he has failed to disaffirm an executed agreement within a reasonable time after becoming of age. *Ratification* consists of a promise on the part of the infant after attaining majority. The promise may, as a rule, be oral or be implied from conduct, although in some states the promise is under some circumstances required by statute to be in writing. In all cases there must be shown an intent to be bound by the agreement. For example, the mere acknowledgment of an agreement does not constitute a ratification.[7]

> A minor executed a mortgage on a tract of land to secure a loan of $3,000. After reaching majority, she ratified the contract. Having done so, she was not allowed to disaffirm the contract thereafter. (Ruehle v. Lange, 223 Mich. 690, 194 N. W. 492)

Disaffirmance may consist of an express repudiation, oral or written, or may be evidenced by such conduct as to indicate clearly that the infant does not intend to be bound by the agreement. To illustrate, if an infant has conveyed property and later, after becoming of age, he sells it to another or sues to recover it, such an act amounts to a disaffirmance.[8] In all cases, however, the agreement must be either ratified or disaffirmed entirely, and not in part only.

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[7] *Kendrick* v. *Neisz*, 17 Colo. 506, 30 P. 245.
[8] *Craig* v. *Von Bebber*, 100 Mo. 584, 13 S. W. 906.

A minor brought an action to recover damages arising out of breach of a contract made with a telegraph company. Holding that the minor was bound by the stipulations in the contract, the court said: "He could not sue upon the contract and repudiate part of it." (Western Union Telegraph Co. v. Greer, 115 Tenn. 368, 89 S. W. 327)

When an infant avoids an agreement, he is not entitled to keep the consideration if he still has it in his possession. His inability to return the benefits he has received, however, does not ordinarily affect his right to avoid the agreement. When the agreement is executory, he may avoid it without returning the consideration; but, if the consideration is still in his possession, he must later return it. If he does not have the thing received, he is ordinarily not estopped from recovering that which he has given. Thus, if an infant receives benefits, as money, which he squanders, or if he receives the protection of insurance which cannot be returned, he may ordinarily disaffirm the agreement without returning the consideration or its equivalent.[9] Some courts, however, hold that a return of the consideration is essential to a disaffirmance of an executed contract on the ground that the privilege of infancy is a shield and not a sword. These courts, however, make an exception in case of conveyances of land, and they permit a disaffirmance by a second conveyance without first returning the consideration. In a few states the privilege of disaffirming an agreement is denied by statute to infants over a specified age, unless they return the consideration or its equivalent.

Insanity. An insane person is under a partial or total disability. His agreements in general are voidable, and the rules in respect to an infant's agreements may also be applied to his. When the person becomes sane, he may ratify or disaffirm these agreements. While the person is insane, the agreements may also be ratified or disaffirmed by his guardian, or by his personal representative or heirs after death. The other party to the agreement or a third party cannot exercise the privilege of avoiding the agreement.

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[9] *Simpson* v. *Prudential Ins. Co.*, 184 Mass. 348, 68 N. E. 673.

There are several exceptions to the rule that the agreements of an insane person are voidable. First, when a person has been judicially declared insane or incapable of handling his affairs by a competent court, and a guardian is appointed, his agreements are considered void in most states. This is provided by statute in some instances. Second, an insane person is held liable for the reasonable value of necessaries furnished himself, wife, or children. This, as in the case of infants, is a quasi-contractual liability, although the necessaries are supplied as the result of an express agreement. Third, although some courts allow avoidance of the agreement by the afflicted party, irrespective of the ignorance and good faith of the other party, most states hold to the contrary when the agreement is just and reasonable. Thus, it is stated that "when a contract is made in ignorance of the insanity, with no advantage taken, and in perfect good faith, a court of equity will not set it aside if the parties cannot be restored to their original position, and injustice would be done." [10]

> Statutes may declare contracts of an insane person void, if made without the consent of his guardian, and provide that the "guardian may sue for and recover any money or property which may have been sold or disposed of by his ward without his consent." (Revised Statutes, Missouri, 1929, Sec. 486)

Lack of capacity cannot be based merely on mental weakness. Although it is not necessary that there be a complete absence of intellectual powers, there must be some mental defect or disease of the mind which renders the person incapable of understanding the nature and consequences of his act. Common causes for incapacity are idiocy, senile dementia, lunacy, and imbecility.[11] When the person is only partially afflicted, as when he has delusions in respect to certain matters only, he may make a valid agreement in respect to other things. So also, when a person is only afflicted with periodic insanity, he may, during lucid intervals, make a binding agreement or ratify or disaffirm previously made voidable agreements.

Married Women. At common law a married woman was under a legal disability. As a general rule she lacked the

[10] *National Metal Edge Box Co.* v. *Vanderveer*, 85 Vt. 488, 82 A. 837.
[11] *Downing* v. *Siddens*, 247 Ky. 311, 57 S. W. (2d) 1.

capacity to enter into a valid contract. Her agreements were absolutely void, hence, not enforceable even though she lived apart from her husband. As her agreements were void, she could not ratify them after the disability due to coverture was removed. For example, if a married woman at common law made an agreement, and later her husband died, a subsequent approval was ineffective.[12]

At common law there were a few exceptions to the rule that a married woman lacked the capacity to make a binding agreement. The disability of coverture was removed if the husband was legally dead because of conviction of certain offenses, such as treason or a felony, or if she had been abandoned absolutely by the husband. A married woman could also acquire contractual rights when she rendered services for another or when she was the payee or transferee of an instrument representing a right against another.

Courts of equity permitted a married woman to have property conveyed to her as her separate estate. In the enjoyment of this right, she could charge her separate property by means of a contract in any form; and when the contract was in writing, as in the case of bills and notes, it was presumed that she intended payment out of her own estate. Thus it seems that in equity a married woman, enjoying the power to contract in respect to the trust property or to alienate it, was "considered a feme sole in respect to property thus settled or secured to her separate use." [13]

The common-law disability of a married woman has been abolished in practically all the states. The incapacity of married women in respect to contracts is now mainly of historic interest. Although the provisions of the statutes in the various states differ, they all tend to give to the wife rights equal to those possessed by the husband. There are still a few restrictions in some states, mainly in instances where the wife might be unduly influenced by the husband, as in acting as surety for him, contracting with him, or joining him in a conveyance of their property.

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[12] *Virginia-Carolina Chem. Co.* v. *Fisher*, 58 Fla. 377, 50 S. 504.
[13] *Johnson* v. *Gallagher*, 3 De Gex F. & J. 494.

Aliens. Because of his political status, an alien is frequently incapacitated in respect to certain legal acts. In general terms, an *alien* may be defined as one who owes allegiance to a country other than that of his residence. Under our laws an alien is, in general, one who has been born without the jurisdiction of the United States and has not been naturalized.

> "An alien in this country is a person born out of the United States and unnaturalized under our Constitution and laws." (Breuer v. Beery, 194 Iowa 243, 189 N. W. 717)

The capacity of aliens to acquire, hold, and transfer property is generally regulated by state statutes, although in some instances by treaties. In most states an alien friend is given equal rights with citizens in respect to contracts. This is particularly true concerning contracts which relate to personal property. On the other hand, a few states prohibit aliens from acquiring and holding real property. So, also, a few states place a disability on nonresident aliens. On the whole, however, the tendency has been to remove the disability of aliens, although at no time has it been oppressive. Thus one court stated that, "as Sir Mathew Hale has said: 'The law is very gentle in the constructions of the disability of alienism and rather contracts than extends its severity.' " [14]

> A corporation borrowed $150,000 from W. A. Black, a Canadian citizen, and gave a mortgage upon real property as security. It was held that the Constitutional and statutory provisions prohibiting aliens from acquiring title to land did not prohibit an alien from enforcing a mortgage upon land. (Cooke v. Coronado Oil Co., 112 Okla. 240, 240 P. 739)

Alien enemies are under greater disability. An *alien enemy* is a citizen or subject of a state against which this country is opposed in war. He cannot enforce contracts during the period of hostility, but when sued he may defend the action. If the contract entered into before the war is of a continuing nature, it is terminated in some instances; but if it is not opposed to public welfare, the tendency is to preserve it by mere suspension for the duration of the war.

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[14] *Harley* v. *State*, 40 Ala. 689.

Convicts. Another form of legal disability sometimes exists in case of persons convicted of felonies or treason. At common law such persons were said to be civilly dead and were denied the capacity to enter into a contract, at least so far as enforcing it on their part. Later a statute was passed in England, placing convicted felons under a complete disability as to contracts and authorizing the appointment of trustees to act for them in respect to their property.

In this country the policy of the common law in respect to the capacity of a convict to enter into a contract has not been followed generally. Thus, when a man imprisoned for life transferred his personal property to his wife, the court announced that the transfer was valid as he still had "a standing in a court of justice" and was "not debarred from the right to sell his property or give it away." [15] There are statutes in some states, however, which place convicts under a partial or total disability. Some statutes provide, in effect, for consequences the same as under the common-law doctrine of civil death, while others follow the English statute. In such cases, however, lack of capacity to act exists only during the period of imprisonment.

Intoxication. A person may in some instances be incapacitated because of intoxication. The fact that a party is slightly intoxicated does not affect his contracts in the absence of fraud. On the other hand, when a person is so drunk that he does not understand the nature of the transaction or the consequences of his act, he is treated practically the same as an insane person. Hence a drunken person is bound by his contracts for necessaries which have been executed. The same is true in respect to any other obligation imposed by law. Other contracts may be avoided or ratified by the intoxicated person when he becomes sober. The rules for affirming an executory agreement or disaffirming an executed agreement are the same in the case of drunken persons as in the case of infants.

Whether the contract can be avoided as against third persons is a question which has not been answered uniformly by

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[15] *Willingham* v. *King*, 23 Fla. 478, 2 S. 851.

the courts. In some instances the question is decided on the basis of the degree of drunkenness at the time of executing the agreement. It is generally held, however, that drunkenness of any degree is no defense against the holder in due course of a negotiable instrument.[16] On the other hand, when one has been judicially declared a habitual drunkard and incapable of transacting his own business, his agreements are void, whether or not made while he was drunk. Thus, when a guardian has been judicially appointed to act for a habitual drunkard, the latter cannot execute a valid contract affecting his property, even though such agreement be made during a period of sobriety.[17]

QUESTIONS

1. Are the following persons under legal or natural incapacity: (a) a married woman at common law, (b) an idiot, (c) an alien, (d) a convict, (e) a lunatic?

2. Ashbourne maintains that a person who lacks capacity to contract has no capacity for legal rights. Do you agree?

3. Rager, an infant, borrowed a sum of money from Kilton. The money was expended for a board bill that Rager had incurred while attending school. Kilton later brought an action in Waldo County, Maine, to recover the money lent to Rager. Was Kilton entitled to judgment?

4. Hamlin brought an action in Lewis County, Kentucky, against Stevenson. The action was prosecuted on the day before Hamlin reached the twenty-first anniversary of his birth. Stevenson contended that Hamlin at the time of the prosecution of the action was still an infant. Do you agree?

5. Miller lent $30 to Alcott, an infant, for the purpose of renting suitable lodging quarters, which Alcott needed. He accompanied Alcott and saw that the money was used for the purpose for which it was borrowed. Could Alcott legally avoid repaying the money on the ground of infancy?

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[16] *Post*, p. 341.

[17] *Anderson* v. *Hicks*, 150 App. Div. 289, 134 N. Y. S. 1018.

6. Johnson, a merchant, brought an action against Lines, an infant, to recover the reasonable value of certain clothes that had been sold and delivered to the infant. It was contended that a merchant may sell clothes to an infant without fear that the infant will be able to avoid payment of the reasonable value of such clothes. Was this contention sound?

7. An infant was the owner of 640 acres of land in Montana. He entered into an agreement whereby he appointed Davis as his agent to sell and convey the land upon finding a purchaser. What was the effect of the agreement?

8. Quincy, an infant, conveyed a tract of land to Gable. While still an infant, Quincy sought to avoid the agreement and to recover the land. Was he entitled to do so?

9. Griffith, an infant, purchased and paid for a diamond ring that was not suitable for his station in life. Ten years after he reached his majority, Griffith attempted to avoid the transaction and to recover the money paid. Was he entitled to do so?

10. Young was declared judicially to be insane, and a guardian was appointed to take care of him. Thereafter Young entered into an agreement for the purchase of certain clothes from a merchant. Was the agreement binding on Young?

11. Wendell brought an action against Callister to recover damages arising out of breach of contract. Callister at the time was an alien enemy. Was Callister entitled to defend the action?

12. Mueller is convicted of a felony and confined for twenty years in a state prison. Do these circumstances affect his capacity to enter a contract?

13. Considine is suing Rickert for breach of contract. Rickert proves that he was intoxicated when the agreement was executed. Does this fact affect the validity of the agreement?

14. Olds purchases a ton of coal from McMahon. It is discovered later that Olds was insane at the time of the transaction. Is his agreement with McMahon binding?

15. Tiles is a citizen of a country which is in armed conflict with the United States. He wishes to bring an action on a contract against Derrin, a citizen of the United States, in a court of the latter country. May he do so?

16. Coligny and Mathieuson are discussing the capacity of a married woman to enter into a binding agreement. The former maintains that a married woman's agreement is void. The latter contends that she is under practically no disability as to the execution of contracts. Do you agree with Coligny or Mathieuson?

Part VII—Form of Agreement

Requirement of Writing. At common law a contract was required to be in writing whenever the validity of the agreement depended upon its form. This group consisted of sealed contracts which were necessary, first, for a promise not supported by a consideration; second, for a conveyance of land by deed; or, third, for an agreement made by a corporation. All other contracts, except negotiable instruments, were valid at common law although they were made orally. Negotiable instruments were required to be in writing in order that they could be used as a substitute for money.

Statutes in all states require that particular contracts be expressed in writing in order to be enforceable. A common illustration is in respect to conveyances of land.[1] Some states require a written promise on the part of an infant after majority or of a debtor after the Statute of Limitations has run, in order that the promisee may bring an action for the old obligation. Again, an acceptance of a bill of exchange is now required in all states to be in writing.[2] The most important legislation in respect to the requirement that certain contracts be written exists, however, in the Statute of Frauds which has been adopted, with some variations, in all the states.

Statute of Frauds. A celebrated English statute,[3] enacted in 1677, required certain specified agreements to be evidenced by a writing in order to be enforceable. The purpose of its provisions is the "prevention of many fraudulent practices, which are commonly endeavored to be upheld by perjury and subornation of perjury." This statute is commonly known as the *Statute of Frauds,* but it is sometimes called the *Statute of Frauds and Perjuries.* It has been substantially followed by legislation in this country.

The provisions of the statute just mentioned specify several kinds of contracts which must be evidenced by a writing. The requirement of writing refers only to executory contracts;

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[1] *Post,* p. 773.
[2] *Post,* p. 319.
[3] *29 Car. 11,* ch. 3.

however, as it is the object of the statute, not to prevent the performance of oral agreements, but to prevent parol evidence from being used to enforce an agreement. Thus a parol agreement fully performed does not come within the provisions of the statute.[4] Nor do the provisions of the statute apply to contracts within the specified class when they are governed by special legislation. Finally the statute does not apply to duties imposed by law, which are known as *quasi-contracts.*

Fourth Section of the Statute. The fourth section of the Statute of Frauds prescribes that "no action shall be brought" on certain agreements, "unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or some person thereunto by him lawfully authorized." These agreements will now be considered.[5]

(1) A special promise of an executor or administrator to answer damages out of his own estate. An executor or administrator is not liable ordinarily to pay the debts of the deceased out of his own pocket. If for any reason he desires to pay such debts personally, he may do so; but under this provision of the statute, his promise to be enforceable must be evidenced by a writing signed by himself or his agent. The statute does not apply to the promise of an executor or administrator to pay the debts of the deceased out of the latter's estate. Nor does it apply when the executor or administrator, for a new consideration moving to himself, promises to pay the debt of the deceased.[6] For example, when an administrator promises to pay a demand of a creditor if the latter will not present his claim against the estate, the promise is an original undertaking and is not within the terms of the statute.[7]

(2) A special promise by one party to answer for the debt, default, or miscarriage of another person. This provision does not include an original undertaking by the promisor. Written evidence is required only when one promises a creditor or obligee to answer for the debts or obligations of

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[4] *Schultz* v. *Noble*, 77 Calif. 79, 19 P. 182.
[5] R., Sec. 178.
[6] R., Sec. 179.
[7] *Blake* v. *Robinson*, 129 Iowa 196, 105 N. W. 401.

another.[8] This provision will be discussed later in connection with suretyship and guaranty.[9]

> Omer Holden made an oral promise to answer for the obligation of another to pay damages arising out of the negligent operation of an automobile. It was held that the promise was unenforceable under the Statute of Frauds. (Gibbs v. Holden, 137 Misc. Rep. 480, 244 N. Y. S. 10)

(3) An agreement in which the promise of one person is made upon consideration of marriage. This provision applies when marriage is the consideration for a promise to pay money or settle property upon another. It does not apply to promises to marry, although such promises may come within a subsequent provision.[10]

(4) An agreement to sell or a sale of any interest in lands, tenements, or hereditaments. This provision requires that the sale of land or of any interest therein must be evidenced by a writing signed by the promisor or his agent.[11] It does not apply to collateral agreements, although they may be remotely connected with the transfer of an interest in land, such as a loan of money to purchase land, a promise to pay for an abstract of title, or, in most states, articles of partnership when the purpose is to deal in land. One of the most difficult problems in determining whether there is a sale of an interest in land arises in connection with the sale of growing crops. This question will be discussed later.[12]

> It is required in some states that the authority of an agent to buy or to sell land be in writing. See statutes of Alabama, California, Colorado, Illinois, Kansas, Michigan, Minnesota, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New York, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Utah, and West Virginia.

(5) An agreement, the terms of which do not call for performance within the space of one year after it is made. This provision in most states applies to contracts which contem-

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[8] R., Secs. 180 to 191 inclusive.
[9] *Post*, p. 370.
[10] R., Sec. 192.
[11] R., Secs. 193 to 196 inclusive.
[12] *Post*, p. 561.

plate nonperformance by both parties within the year. Some states, however, hold that it applies where there is to be nonperformance by one party within the year.[13] It does not apply where it is possible to perform within the year, although it is in fact not so performed. Thus, when no time is fixed for performance, or when there is a promise to do an act at or until the marriage or death of a person, the agreement need not be evidenced by a writing.[14]

Seventeenth Section of the Statute. The seventeenth section of the English Statute of Frauds prescribes that "no contract for the sale of any goods, wares or merchandise, for the price of ten pounds sterling, or upwards, shall be allowed

This Agreement made this _____ day of _____,

by and between _____ of _____, party of

the first part, and _____ of _____, party

of the second part,

WITNESSETH, that the said party of the second part, in consideration of

the agreements hereinafter set out, agrees to and with the party of the first part, to

[Here may be inserted the subject-matter of the contract.]

In consideration of which the party of the first part agrees to pay to the party of the

second part the sum of _____

when the party of the second part shall have fully completed the things so agreed by him

to be done.

(Signed by) _____ (SEAL)

_____ (SEAL)

FORM OF SIMPLE CONTRACT

[13] The Restatement says that in such case the statute applies only until the other party has completely performed what he has promised. Sec. 198.

[14] *Carr* v. *McCarthy*, 70 Mich. 258, 38 N. W. 241.

to be good, except (1) the buyer shall accept part of the goods so sold and actually receive the same, (2) or give something in earnest to bind the bargain, or in part payment, (3) or that some note or memorandum in writing of the said bargain be made and signed by the parties to be charged by such contract, or their agents thereunto lawfully authorized."

This section has been followed with more or less modification in most of our states.[15] Because its provisions deal with the sale of commodities, a discussion of it will be presented later in connection with the law of sales.[16]

Note or Memorandum. The note or memorandum required by the statute is only evidence of the agreement. It need not be in any prescribed form, but it should contain all of the ma-

Maximum Amounts for Which Sales May Be Made in the Various States, Alaska, the District of Columbia, and Hawaii without Coming under the Statute of Frauds

Alabama	$500	Montana	$200
Alaska	50	Nebraska	500
Arizona	500	Nevada	50
Arkansas	30	New Hampshire	500
California	500	New Jersey	500
Colorado	50	New Mexico	50
Connecticut	100	New York	50
Delaware	none required	North Carolina	none required
District of Columbia	50	North Dakota	500
Florida	all sales	Ohio	2,500
Georgia	50	Oklahoma	50
Hawaii	100	Oregon	50
Idaho	500	Pennsylvania	500
Illinois	500	Rhode Island	500
Indiana	500	South Carolina	50
Iowa	all sales	South Dakota	500
Kansas	none required	Tennessee	500
Kentucky	500	Texas	none required
Louisiana	none required	Utah	500
Maine	500	Vermont	40
Maryland	50	Virginia	none required
Massachusetts	500	Washington	50
Michigan	100	West Virginia	none required
Minnesota	50	Wisconsin	50
Mississippi	50	Wyoming	50
Missouri	30		

[15] R., Sec. 178.
[16] *Post*, Chapter IX, Part II.

terial facts.[17] It should state the names of the parties or otherwise indicate them so that they may be identified. Thus, a description of the parties may be sufficient.[18] The subject matter must also be shown, but a reference to it is sufficient as the courts allow such reference to be explained. The consideration should be expressed, although some courts do not require a statement of the consideration. This question is frequently governed by statutes, some of which require an expression of the consideration, whereas others do not. The writing should also set forth all material terms, especially conditions or special requirements.[19]

> When a memorandum fixes no time for delivery, the rule is: "If the parol agreement fixed no time for delivery, the memorandum evidencing the contract is sufficient under the statute, since it contains all the terms agreed on. In such case the law supplies the missing terms and requires delivery within a reasonable time. If, on the other hand, the time is fixed by the parties, the memorandum is insufficient." (Berman Stores Co. v. Hirsh, 240 N. Y. 209, 148 N. E. 212)

The note or memorandum must also be signed[20] by the party to be charged[21] or by his lawfully authorized agent. Some statutes require the authority of the agent to be in writing, at least in respect to certain agreements. For example, some statutes require the authority of the agent to be in writing in case of contracts relating to land.[22] In case of an auction, it is the usual practice for the auctioneer to be the agent of both parties for the purpose of signing the memorandum. If, however, the vendor himself acts as auctioneer, he cannot sign as agent for the buyer. The signature may be made upon the writing at any place, in the absence of statute, and may be made by mark, engraving, or any other means as long as it is adopted as a signature.

> In some states the signature may not appear at any place, for example when a statute reads: "When the law requires any writing to be signed by a party thereto, it shall

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[17] R., Sec. 209.
[18] *Bibb* v. *Allen*, 149 U. S. 481, 37 L. Ed. 819.
[19] R., Sec. 207.
[20] R., Sec. 210.
[21] R., Sec. 211.
[22] *Thomas* v. *Rogers*, 108 Minn. 132, 121 N. W. 63.

> not be deemed to be signed unless the signature be subscribed at the end or close of such writing." (Rowe v. Ratliff's Heirs, 225 Ky. 70, 7 S. W. [2d] 852)

The note or memorandum may consist of one instrument or of separate papers, as letters or telegrams.[23] It may be made at the time of the original transaction or at a later date.[24] It must, however, ordinarily exist at the time an action is brought on the agreement.[25]

Effect of Noncompliance. Under the English statute noncompliance with the terms thereof does not render the agreement void, but merely voidable. This is also true in most of our states, but there are a few statutes which declare the agreement void unless it is in writing. On account of the fact that the agreement is voidable only, it is enforceable unless noncompliance with the statutory requirements is set up by the person who will receive the benefit.[26] "The Statute of Frauds was enacted for the protection of the party sought to be charged. It is personal and not available to strangers to the agreement." [27] Although at law the courts will protect the rights of the parties where an oral contract is executed, they will not recognize a partially executed agreement, in the absence of statutory provisions stipulating that part performance removes the agreement from the operation of the statute. When one party has performed under the agreement, however, the courts will allow him to recover the value of his performance.

> "If the agreement is within the Statute of Frauds, and, therefore, not binding on the defendant, the complainant nevertheless has the right to recover the value of his services, and the money advanced by him to the defendant under the agreement." (Carter v. Witherspoon, 156 Miss. 597, 126 S. 388)

In equity the courts sometimes will enforce oral agreements when one party has performed. Such cases usually re-

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[23] R., Sec. 208.
[24] R., Sec. 214.
[25] R., Sec. 215.
[26] R., Sec. 218.
[27] *Ringler* v. *Ruby*, 117 Oreg. 455, 244 P. 509.

late to land.[28] For example, when a vendee enters upon the land and makes valuable imporvements, the agreement may be enforced in equity although it be oral.[29] On the other hand, the payment of the price or possession alone has been held to be insufficient. There must be something done which points toward the agreement claimed and to the fact that there was reliance thereon. "The whole doctrine rests upon the principle of fraud, and proceeds upon the idea that the party has so changed his situation, on the faith of the oral agreement, that it would be a fraud upon him to permit the other party to defeat the agreement by setting up the statute." [30]

QUESTIONS

1. Manship and Shearson are discussing the form in which an agreement is required to be made. The latter contends that at common law no agreement was required to be in writing. The former maintains that simple contracts were unenforceable at common law unless they were in writing. Do you agree with Manship or Shearson?

2. In an article on the subject of public regulation of business, the following statement appears: "The Statute of Frauds was enacted to prevent, in sales and other transactions, false representations of a nature for which actions for deceit could be maintained." Is this statement correct?

3. Sayes was appointed the executor to administer the terms of a will under the laws of the state of Vermont. The will cut off Belden, an heir of the deceased. Belden threatened to contest the will on the ground of undue influence. Sayes orally promised to pay a certain sum of money to Belden in return for Belden's promise to refrain from contesting the will. Belden brought an action to recover the amount promised, and Sayes as a defense pleaded the Statute of Frauds. Was Belden entitled to judgment?

4. Anna E. Cochrane alleged that the estate of Michael McEntee, deceased, owed to her a certain debt. Teresa A. McEntee, executrix of the estate, allegedly made an oral promise to pay the debt. An action was brought in a court in New Jersey by Mrs. Cochrane to recover the amount of the debt from Teresa A. McEntee. If the facts alleged were true, was the executrix liable?

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[28] R., Sec. 197.
[29] *Holmden* v. *James*, 42 Kans. 758, 21 P. 591.
[30] *Brown* v. *Hoag*, 35 Minn. 373, 29 N. W. 135.

5. Williams orally promised to pay the sum of $1,000 to Reams in consideration of Reams marrying a designated lady. Reams married the lady, but Williams refused to pay the promised sum. Was Reams entitled to enforce the promise of Williams?

6. Dowan purchased certain cotton from Roberts at an auction sale in South Carolina. Thereafter, Dowan brought an action to recover for breach of contract. It was contended that an auction sale did not come within the provisions of the seventeenth section of the Statute of Frauds. Do you agree?

7. Van Buren orally agrees to sell his farm to Cornwallis. He gives the latter a memorandum as follows: "On this date I hereby agree to sell my farm, Black Acre, to Cornwallis for $15,000. T. J. Van Buren." Cornwallis later refuses to carry out the agreement. May Van Buren maintain an action for breach of contract?

8. Keller made an oral agreement to purchase a tract of land from the City Realty Company. At the same time he wrote a memorandum of the agreement, which he signed, although the company did not sign. When Keller failed to perform, the company brought an action for damages. Was the City Realty Company entitled to judgment?

9. R. S. Geary orally agreed to convey a tract of land to Randall Forester. Subsequently Forester brought a suit in equity to compel Geary to perform his promise. He offered in evidence the fact that he had paid a certain sum of money in part payment. Was Forester entitled to a decree in his favor?

10. Alfred Folland entered into an oral agreement with C. H. Henry whereby he promised to construct a building for Henry for a specified sum of money at a date two years later. As a reminder of the transaction Folland sent Henry a letter in which he set forth the terms of the agreement. Thereafter when Folland failed to perform as agreed, Henry brought an action to recover damages. Folland set up the Statute of Frauds as a defense. Was Henry entitled to judgment?

11. Fred Wilson entered into an oral agreement to convey a half interest in a tract of land to W. H. Crow. When Wilson failed to perform as agreed, Crow brought an action against him to recover damages. After the action was brought, Wilson signed a memorandum of the agreement. Was Crow entitled to judgment?

12. L. M. Wheary and F. G. Nanley entered into an oral agreement that could not be performed by either party within a period of one year. Thereafter a memorandum of the agreement was made and signed by Wheary. When sued by Nanley, Wheary contended that the memorandum was not valid because Nanley was identified only by the title "President of the First State Bank." Was his contention sound?

Part VIII—Operation of Contracts

Extent of Relation. After learning the elements necessary to create an enforceable agreement, the next step is to ascertain the extent of the relation. In other words, who have obligations, and upon whom are rights conferred by the terms of the contract?

Liabilities. A contractual obligation ordinarily arises only by consent; hence no liability is incurred under the terms of a contract by anyone who is not a party to it. A contract may impose a duty on the part of others to refrain from malicious interferences with its performance, but such duty does not arise out of its terms. This duty will be discussed under a later topic.[1]

Rights. The rule in respect to liabilities is also, in general, applicable to rights arising out of a contract. In other words, it may be said that ordinarily a contract confers no rights upon one who is not a party to it even though he receives an incidental benefit therefrom.[2] For example, when one party agrees to furnish water to another, the former cannot be sued for breach of contract by a third party in case of a failure to perform.[3]

When the promise of one party, however, is expressly made for the benefit of a third person, the authorities are not uniform upon the question whether the latter can sue for a breach. Let us assume that Brown gives a consideration to Green in return for the promise of the latter to pay a certain sum of money to White. The English decisions hold that White cannot maintain an action for breach of contract on the ground that "no stranger to the consideration can take advantage of a contract, although made for his benefit." [4] They make an exception, however, in contracts of insurance and in cases where the agreement is such as to make the promisor a trustee, in which case the third party or beneficiary may enforce the trust in equity. Massachusetts and a few other

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[1] *Post*, p. 890.
[2] R., Sec. 147.
[3] *Boston Safe Deposit & Trust Co.* v. *Salem Water Co.*, 94 F. 238.
[4] *Tweddle* v. *Atkinson*, 1 Best S. 393.

states follow the English doctrine but make one or more exceptions, as, for example, when the promisor undertakes to deliver to a third party assets which in good conscience belong to the third party.[5] Most states, however, allow recovery by a third party beneficiary, making little distinction between donee and creditor beneficiaries.[6] Also, it is ordinarily held that such recovery cannot be defeated by the promisee giving a release to the promisor.[7] These questions are now frequently governed by statutes.

In many instances a person who is not to receive the performance of a contract between two other persons may gain some benefit from the performance of such contract. Such a person is known as an *incidental beneficiary.* It is quite generally held that an incidental beneficiary acquires no rights under the contract.[8]

> A company promised an employee that it would furnish medical attendance in case of an accident. A physician whose services were obtained by the employee sought to hold the company on the contract with the employee. He was not allowed to recover, although performance of the contract would result incidentally to his benefit. (Thomas Mfg. Co. v. Prather, 65 Ark. 27, 44 S. W. 218)

When contracts have been made through agents, the principal has rights and liabilities under the terms of the contract, but he is in law a party to the contract. So, also, in the case of an assignment, although apparently an exception to the rule, the assignee is, after all, a party to the contract.

Assignment by Operation of Law. Under some circumstances there may be a substitution of others for the original parties to a contract. When one party steps into another's place, the change is brought about by an operation known as

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[5] *Exch. Bank of St. Louis* v. *Rice*, 107 Mass. 37, 9 Am. Rep. 1.

[6] The Restatement permits enforcement both by one to whom the benefit is given, called a donee beneficiary, and by one to whom the promisee owes a duty, called a creditor beneficiary. Sec. 133.

[7] It is permitted by the Restatement in case of a creditor beneficiary, unless he has materially changed his position without notice of the discharge or unless such action is a fraud on creditors. Sec. 143. As to a donee beneficiary, see Sec. 142.

[8] R., Sec. 147.

an *assignment* of the contract. One form of assignment is by operation of law.

It will be shown later that the marriage of a woman at common law gave her husband by operation of law the right to reduce her claims against others into possession, after which he was absolutely entitled to that which was obtained.[9] It will also be shown later that where there is an express assignment of interests in land, certain obligations are transferred by operation of law, because they are said to run with the land.[10]

Two of the most common examples of an assignment of contracts by operation of law occur in the case of death and the adjudication of bankruptcy. Upon the death of a person all rights on contracts in connection with his personal estate pass to his executor or administrator. For example, where the deceased is the payee of a note found among his assets, the executor may enforce it or transfer it by endorsement and delivery.[11] In case of an adjudication of bankruptcy, rights on contracts of the bankrupt, unless the contracts are exempt, pass by operation of law to the trustee in bankruptcy.[12]

Assignment by Act of Parties. An assignment of a contract may also, under some circumstances, be made by the act of the parties. In such cases, the one making the assignment is known as the *assignor,* and the one to whom it is made is known as the *assignee.*[13]

Liabilities. In the absence of the consent of the other party, one is not allowed to assign his liabilities under a contract. The basis for this rule is that "everyone has a right to select and determine with whom he will contract, and cannot have another person thrust upon him without his consent. In the familiar phrase of Lord Denman: 'You have the right to the benefit you anticipate from the character, credit, and sub-

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[9] *Post,* p. 746.
[10] *Post,* pp. 790, 849, and 850.
[11] *Stone* v. *Rawlinson,* Willes' Rep. 559.
[12] *Post,* p. 960.
[13] R., Sec. 149.

stance of the party with whom you contract.' "[14] One may, however, turn over to another for performance his duties under a contract when such work does not involve personal skill or special qualifications.[15] This delegation of duties is not an assignment, and the party remains liable for the proper carrying out of the terms of the agreement.

A construction company, selected for its skill and experience, promised to build and equip a canning factory. It was held that the company could not delegate its duties to another without the consent of the promisee. (Johnson v. Vickers, 139 Wis. 145, 120 N. W. 837)

Rights. In the absence of a new contract between the original parties and a third person, one could not assign his rights under a contract at early common law, except in the case of negotiable instruments. In equity, however, an assignment of rights under a contract was permitted so long as the contract did not call for the performance of personal services or acts involving personal confidence or credit.[16] Thus, although a right to the services of a person may not be assigned, the employee, on the other hand, may assign his right to wages due.[17]

Peoria, Illinois, October 10, 19

For value received, I hereby assign to Richard Allen all my right, title, and interest in the attached contract for the distribution of the products of the Superior Manufacturing Company in the State of Illinois.

Geo. Stimpson

ASSIGNMENT

Form and Notice of Assignment. In the absence of statute, no particular form is required in order to execute a valid assignment.[18] It may be made orally, or by conduct which

[14] *Arkansas Valley Smelting Co.* v. *Belding Min. Co.*, 127 U. S. 379, 32 L. Ed. 246.
[15] R., Sec. 160.
[16] R., Sec. 151.
[17] *Adler* v. *Kans. City, Springfield & Memphis R. R. Co.*, 92 Mo. 242, 4 S. W. 917.
[18] R., Sec. 157.

evidences an intention to assign. In some states, however, an assignment is required by statute to be in writing for certain purposes. Although one may assign a claim absolutely or conditionally,[19] he cannot assign a part of it at common law, except with the consent of the obligor.[20] This rule is based on the right of the latter to pay his debt as a whole and to be free from separate actions brought by different persons. In equity, however, partial assignments are generally recognized, because in a suit by the holder of any part of the claim, the rights of all may be determined.

> "When he (referring to the debtor) undertakes to pay an entire sum to his creditor, it is no part of his contract that he shall pay it in fractions to other parties. His obligation is single, and he should not be harrassed with different actions to recover parts of one demand. In equity, however, the rule is different." (State Bank of Sheridan v. Heider, 139 Oreg. 185, 9 P. [2d] 117)

Notice to the debtor is not required in order to complete the assignment as between the assignor and the assignee. In respect to the debtor, however, the assignment is not complete until he has been given notice.[21] For example, when a mortgagee assigns the mortgage, and the mortgage debt is later paid to him by the mortgagor, the latter is not liable to the assignee, provided he was not given notice of the assignment.[22] In the absence of statute, notice of an assignment may be given in any manner. No particular form is necessary, except that it must bring to the debtor's knowledge the fact that an assignment has been made.

Rights of Assignee. After notice of the assignment is given to the debtor, the assignee is entitled to enforce the obligation. An assignee, however, has only the rights of his assignor; hence any defense which is valid against the latter at the time of the notice may be used against him.[23] To illustrate, the rights of an assignee are subject to defects in the original

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[19] R., Sec. 150.
[20] R., Sec. 156.
[21] R., Sec. 167.
[22] *Van Keuren* v. *Corkins*, 66 N. Y. 77.
[23] R., Sec. 167.

contract, such as fraud; to other equities, such as payment by the obligor to the assignor before notice of the assignment is received; and to defenses against the assignor such as the Statute of Limitations.[24]

> A seller of lumber assigned his right to the purchase price to L. W. Grant, but he failed to deliver the goods as agreed to the buyer. The defense of breach of contract, which the buyer could assert against the seller, was also a valid defense against the assignee. (Grant v. Sicklesteel Lumber Co., 155 Mich. 600, 119 N. W. 1092)

In courts of law the assignee, in the absence of statute, is required to bring action on the contract in the name of the assignor. He is permitted to sue in his own name in the courts of equity, but an assignee of a legal right is not entitled to bring suit in such courts, "unless it appears that the assignor prevents and prohibits such action from being brought in his name, or that an action so brought would not afford an adequate remedy at law." [25] Statutes in most states permit an assignee to bring an action in his own name in courts of law.

> Referring to a Virginia statute and decisions thereunder, a court said: "It is therefore clear that under this statute and these decisions suit may be brought in one of three ways—in the name of the original obligee or payee, in his name for the use of the assignee, or in the name of the assignee alone." (Carozza v. Boxley, 203 F. 673)

The holder of a claim against another may perhaps assign his claim to successive parties, in which case a question arises as to the rights of these parties in respect to the obligation. Many courts adopt the view that the first in time has priority on the theory that the second and third assignees can receive nothing from the assignor because he has parted with his claim by the first assignment.[26] The Supreme Court of the

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[24] *Webb* v. *Baltimore Commercial Bank*, 181 Md. 572, 31 A. (2d) 174.

[25] *Walker* v. *Brooks*, 125 Mass. 241.

[26] This view is adopted by the Restatement, except when the first assignment is revocable or voidable or when the second assignee without notice obtains payment, a judgment against the obligor, a new contract with the obligor, or a token or writing necessary to enforce the contract of the obligor. Sec. 173.

United States and other courts follow the English doctrine that the assignee first giving notice to the obligor is entitled to priority. The first rule may be commendable in theory, but the latter is valuable in preventing frauds. It permits purchasers to protect themselves by inquiring of the debtor as to whether there has been a previous assignment, and the assignee who fails to give notice loses out, similarly as one does when he fails to give constructive notice by recording or filing a mortgage or deed.

Joint, Several, and Joint and Several Contracts. Contracts are frequently executed so that several persons are under an obligation to perform an act. In such cases their contracts may be joint, several, or joint and several.[27]

Joint Contracts.[28] A joint contract is one in which two or more persons jointly promise to perform some obligation.[29] Although each is liable for the entire obligation, an action on the contract must be brought against all who are living and are within the jurisdiction of the court.[30] If one is sued and no objection is raised, he is bound by the result of the trial. A judgment secured against one, however, discharges the others in the absence of statute to the contrary.[31] The same is true when the promisee releases one of the promisors.[32] In case of the death of one of the joint promisors, liability for the obligation will rest, in the absence of statute, upon the survivors.[33] Equity follows this rule when the deceased derived no benefit; but when circumstances make it inequitable, the court will not do so. For example, where the two joint promisors borrow money, equity may sustain an action against the

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[27] R., Sec. 111.

[28] Many states have statutes which change the common-law rules with respect to joint obligations as here stated. See, also, the Uniform Joint Obligations Act, now known as a Model Joint Obligations Act, 9 Uniform Laws Annotated, page 429, and 1944 Accumulative Annual Pocket Part, page 79.

[29] R., Sec. 112.

[30] R., Sec. 117.

[31] R., Sec. 119.

[32] R., Sec. 121.

[33] R., Sec. 125.

personal representative of the deceased promisor.[34] The rules of joinder in a suit and of survivorship also apply to joint promisees or creditors.[35]

> "We find that the authorities generally hold that a note payable to husband and wife jointly belongs in the event of the death of either to the survivor, and that an action brought on the note after the death of one must be instituted by the survivor." (Ehrlich v. Mulligan, 104 N. J. L. 375, 140 A. 463)

Several Contracts. Several contracts are those in which two or more persons separately and distinctly, although by the same instrument, agree to perform the same obligation.[36] They are liable severally and, in the absence of statute, cannot be joined in one suit. Judgment against one does not discharge the others. The same is true when one of them is released. The liability of one does not pass upon his death to the survivors as in the case of joint contracts. Thus, upon the death of the maker of a several contract, the promisee may maintain an action against his executor or administrator.[37]

> "The stockholders of all corporations and joint-stock companies shall be liable for the indebtedness of a corporation to the amount of the stock subscribed. Section 3, art. 11, Const. State of Oregon. . . . The liability of a stock subscriber is several and not joint." (Laing v. Hutton, 138 Oreg. 307, 6 P. [2d] 884)

Joint and Several Contracts. A joint and several contract is one in which two or more persons bind themselves jointly and also severally.[38] In such cases the creditors may elect to treat the promises of the parties as one joint obligation or as separate and distinct obligations. To illustrate, when there is a joint and several contract, the creditor may bring an action against each of the promisors at the same time.[39]

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[34] *Pickersgill* v. *Lakens*, 82 U. S. 140, 21 L. Ed. 119.
[35] R., Secs. 129 and 132.
[36] R., Sec. 113.
[37] *Ludlow* v. *McCrea*, *1 Wend.* (N. Y.) 228.
[38] R., Sec. 114.
[39] *Simonds* v. *Center*, 6 Mass. 18.

QUESTIONS

1. Joseph A. Gardner and Edward Gerrish entered into a written agreement. Gerrish, in return for Gardner naming his son Edward Gerrish Gardner, promised to pay to the son the sum of $10,000. Thereafter the son brought an action to enforce the promise made by Gerrish. Was he entitled to do so?

2. Malanaphy & Daly, a firm engaged in business in Decorah, Iowa, transferred certain farm implements to another firm, Christen & Gilbertson. Under the terms of the agreement Christen & Gilbertson promised to pay a certain sum of money to the Fuller & Johnson Manufacturing Company, to whom Malanaphy & Daly owed this amount. Was the Fuller & Johnson Manufacturing Company entitled to enforce the promise of Christen & Gilbertson?

3. Keowns and Andowsky are discussing the transferability of contracts. The former states that contracts can be assigned only by acts of the parties. Do you agree?

4. Damen has a claim against Huggins which he assigns to Bellinger on January 10 and to Leighton on January 15 of the same year. Leighton notifies Huggins of the agreement on January 20, three days before Bellinger gives notice. Who is entitled to enforce the claim against Huggins?

5. Kildare and Huyler enter into a joint contract with Krantz. Upon failure of performance by Kildare and Huyler, Krantz brings an action against Kildare on the contract. Kildare maintains that Krantz cannot sue him without joining Huyler as a codefendant. Is his contention sound?

6. Earl Anderson entered into a contract whereby he agreed to work as a gardener for Richard S. Morrison for a period of three years. Six months later Morrison transferred his right to the services of Anderson to the Alden Nursery. Anderson refused to work for the nursery. Was he liable for damages?

7. Curran assigned his claim for wages due under an employment contract to Kane. Was Kane entitled to collect the amount due?

8. Walter Andrews allegedly owed Frierson the sum of $3,931 for auction fees. Frierson gave Gann, of Atlanta, Georgia, an order on Andrews for one half of the alleged debt. It was contended that the order was an assignment. If this allegation was true, was Gann entitled to sue Andrews for one half of the debt?

9. W. C. Campbell and others were under an obligation to pay certain rentals to Mrs. L. E. Alexander. Mrs. Alexander assigned her rights to a bank in Washoe County, Nevada. Without notice of the assignment, the debtors made a settlement with Mrs. Alexander. Was the bank entitled to collect from the debtors?

10. Kermit assigns a claim against Parks to Eisinger. Eisinger calls Parks by telephone and tells him of the assignment. Later Parks pays Kermit and is sued by Eisinger. Parks maintains that he was not properly notified. Is this defense valid?

Part IX—Discharge of Duties

By Agreement. The duties of one party or of both parties to a contract may be terminated by some express or implied provision in the original agreement or by some subsequent agreement. Hence duties under a contract may be discharged by a condition subsequent, by rescission, waiver, or cancellation, or by a substituted agreement.

Condition subsequent. The parties may specify in the original agreement that the contract will terminate upon the happening of a given event, such as the destruction of a building or a flood.[1] They may also agree that one or both may elect to terminate the contract. For instance, either the employer or the employee may be entitled to end the relation with proper notice,[2] or the vendee may return goods in accordance with a sale "with option to return." [3]

> "A condition subsequent refers to a future event upon the happening of which the obligation becomes no longer binding on the party in whose favor the condition was created if he chooses to enforce it. Civ. Code, Sec. 1438." (Lowe v. Copeland, 125 Calif. A. 315, 13 P. [2d] 522)

Rescission. The parties may agree subsequently to the execution of the contract that it will not be binding on either of them, in which case the rights of the parties are the same as they were before the contract was made.[4] Mutual rescission may ordinarily take the form of an oral or implied agreement, as well as a written agreement, except in the case of sealed instruments at common law and in case of contracts involving land under the Statute of Frauds. A contract to transfer an interest in land immediately transfers an equitable interest to the buyer, hence a rescission amounts to a retransfer of such interest [redacted] to the seller, and the rescission under the Statute of Frauds therefore must be evidenced by a writing. Even in case of these exceptions, however, an executed oral agreement operates to discharge the contract.[5]

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[1] R., Sec. 396.
[2] *Post*, p. 252.
[3] *Post*, p. 576.
[4] R., Sec. 406.
[5] R., Secs. 219 and 407.

Closely akin to rescission is discharge by *waiver* and *cancellation.*[6] The former is a voluntary relinquishment of rights under a contract; and the latter is the renunciation of rights under a written contract by destroying the legal effect of the instrument in some manner.[7] Unlike mutual rescission, however, they do not return the parties to their original positions.

> "No principle of law or equity prevents the waiver by parties of such terms of a contract, however explicit may be its phraseology. Waiver may be manifested by acts as well as by words." (Porter v. Harrington, 262 Mass. 203, 159 N. E. 530)

Substitution. The parties may expressly agree that one contract will be substituted for another, in which case the duties under the original contract are discharged.[8] An agreement to this effect may also be implied. For example, when a new contract is clearly inconsistent with an original agreement, the latter is deemed abandoned or relinquished, although there is no express stipulation in respect to a substitution.[9] The same rule applies when there exists an inconsistency between the terms of an original agreement and the terms of a later contract. In some cases there may be a substitution of one contract for another when the new contract contains the same terms, but has different parties.[10] This is known as a *novation.*[11]

> "To constitute a 'novation' there must be three parties to the agreement of novation, namely, the creditor, the original debtor, and the third person who is to become the new debtor. They must all agree that the original debtor be released and that the third person be substituted in his stead." (Hicksville Handle Co. v. Herb [Mo. A.], 226 S. W. 63)

Closely akin to the discharge of a contract by substitution is an agreement which is made and executed in satisfaction of rights which one has against another in accordance with

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[6] R., Sec. 432.
[7] *Post*, p. 350.
[8] R., Sec. 418.
[9] *Singleton* v. *Atlantic Coast Line R. Co.*, 203 N. C. 462, 166 S. E. 305.
[10] R., Secs. 425 to 430 inclusive.
[11] R., Sec. 424.

the terms of a former contract. This is known as an *accord and satisfaction.*[12] An accord is the agreement to take some performance as a satisfaction, but it alone will not discharge the right of action. The accord must be executed, or, in other words, the performance must be tendered and accepted. An exception is made, however, when the promise itself, not the performance, is intended as the satisfaction. Thus, after acknowledging the general rule, a court stated that "nevertheless, if the parties agree that the new promise shall constitute satisfaction of the existing debt, and the new agreement is based upon a new consideration or the possibility of a benefit to the creditor, to which he was not before entitled, and such promise is accepted in satisfaction, then such new agreement constitutes an accord and satisfaction, and is a bar to an action on the original debt." [13]

Impossibility. Impossibility of performance may exist at the time of the agreement, or performance may become impossible subsequently. When both parties know of, or when both parties are ignorant of, the impossibility at the time of making the agreement, there is no contract to terminate. In the first case, lack of consideration renders the agreement unenforceable,[14] and in the latter case there is the same result on the ground of mistake.[15] If the promisor alone knows of the impossibility then existing, the agreement is unaffected as a general rule, for it is deemed that he intended to make himself liable.

> "Whether or not the provision of the contract for the delivery of the original letters patent was impossible of performance at the time the contract was made is immaterial; for if it were so, its impossibility, although known to the plaintiff, was not known to defendant, and it must, therefore, be held that the plaintiff intended to make himself absolutely liable." (Paine v. Parkhurst, 205 F. 740)

Impossibility to perform arising subsequently to the agreement will not as a general rule discharge the promisor. This

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[12] R., Sec. 417.
[13] *Ohlendiek* v. *Schuler,* 299 F. 182.
[14] *Ante,* p. 88.
[15] R., Sec. 456.

rule has been modified by some courts when such an event appears not to have been within the contemplation of the parties. Tornadoes, lightning, and floods, however, are events which, although they render performance impossible, do not discharge the contract. "The general rule is that one who makes a positive agreement to do a lawful act, is not absolved from liability for a failure to fulfill his covenant by a subsequent impossibility caused by an act of God, or an unavoidable accident, because he voluntarily contracts to perform it without any reservation or exception, which, if he desired, he could make in his agreement, and thereby induces the other contracting party, in consideration of his positive covenant, to enter into and become bound by the contract." [16]

Destruction of Subject Matter. When there is a contract in respect to a particular subject matter that is later destroyed without the fault of the parties, the agreement is discharged.[17] For example, when there is a promise to sell the crop to be grown on a specific piece of land, and the crop is destroyed by blight, the duties under the contract have been deemed discharged. This is based on the theory that the parties have assumed that the subject matter will continue to exist; hence the continued existence of the subject matter is a condition to the contract. If, on the other hand, there is simply a general undertaking to raise and sell, for example, a given quantity of beans, without limitation or restriction as to a particular piece of land, and the crop is destroyed by frost or blight, the promisor is not discharged.[18]

A company agreed to furnish certain millwork, but it failed to do so when its mill was destroyed. Destruction of a specific thing necessary for performance will discharge a duty under the same conditions as the destruction of the subject matter. In this case the company was not discharged, because "it undertook an absolute obligation to furnish the contracted millwork in any event, whether it was to or could be later manufactured by its own milling plant or would have to be obtained in the market from the mill of another." (Kentucky Lumber & M. Co. v. Rommell Co., 257 Ky. 371, 78 S. W. [2d] 52)

[16] *Berg* v. *Erickson*, 234 F. 817.
[17] R., Sec. 457.
[18] *Anderson* v. *May*, 50 Minn. 280, 52 N. W. 530.

Changed Laws. A contract is dissolved when its performance is made illegal by a subsequent change in the law of the country in which the contract is to be performed.[19] To illustrate, the duty under an agreement to rebuild a non-fireproof structure is discharged when a law is enacted prohibiting the construction of buildings not of fireproof construction within that particular zone.[20] Mere inconvenience or temporary delays caused by the law, however, will not excuse performance.

> After a company had agreed to deliver twenty carloads of fir lumber, the government ordered a lumber embargo, requiring releases for shipments to be obtained from a district officer. It was held that the company was not discharged from performance, except to the extent of the delay caused, because "the effect of like governmental regulations has been generally held to extend the time for delivery, but not to vitiate the contract." (Washington Mfg. Co. v. Midland Lumber Co., 113 Wash. 593, 194 P. 777)

Death or Inability. When a person is to do an act under the terms of an agreement which contemplates a personal relation, his death or disability discharges the contract.[21] Thus, "where the agreement is for services which involve the peculiar skill of an expert by whom alone the particular work in contemplation of the parties can be performed, and where distinctly personal considerations are the foundation of the contract, the relation of the parties is dissolved by the death of him whose personal qualifications constitute the particular inducement to the contract." [22] If, however, the acts can be performed by others or by the promisor's personal representative, the rule does not apply.

> Samuel Clark entered into several contracts to build oil derricks. It was held that these contracts, as in case of building contracts in general, did not call for personal acts of the contractor and hence were not discharged by his death. (Mackay v. Clark Rig Bldg. Co., 5 Calif. A. [2d] 44, 42 P. [2d] 341)

Acts of the Parties. When the promisee prevents or otherwise makes performance impossible, the duties of the promisor

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[19] R., Sec. 458.
[20] *Poledor* v. *Mayerfield*, 94 Ind. A. 601, 173 N. E. 292.
[21] R., Sec. 459.
[22] *Volk* v. *Stowell*, 98 Wis. 385, 74 N. W. 118.

are discharged.[23] Thus, when a subcontractor, who has agreed to construct a bridge, cannot render performance because of an act of the contractor, such as refusing to furnish as agreed materials, equipment or money, the subcontractor may treat his duty to proceed under the contract as discharged.[24] This rule may be based upon the doctrine, first, that one cannot take advantage of his own wrong; second, that there is an implied promise to do nothing to render performance impossible; or, third, that the act of preventing performance amounts to a waiver of the right to require performance.

By Operation of Law. Under some circumstances the law may operate to discharge a contract. In other instances, although the law does not operate to discharge the contract, it does deny a right of action thereon, which in most instances has practically the same result.

Alteration. The alteration of a written contract, simple or under seal, will ordinarily discharge the duties of the other party to the instrument. For example, when an advertising contract was altered by adding "at monthly payment basis," thus making the rate of payment higher, the advertiser was discharged from any duty thereunder.[25] It is usually immaterial whether the party has been injured. The discharge of a contract by alteration, however, results only when, first, there is a material change, such as an alteration in the legal effect of the instrument; second, the alteration is made by a party to the contract, and not a stranger; third, it is made intentionally, and not through accident or mistake; and, fourth, it is made without the consent of the other party.[26] These requirements seem to be modified in some instances by statute.[27]

> Under statutes the maker of a note or the drawer of a check or draft is not entirely discharged by an alteration, but he remains liable for the original amount thereof, if the instrument is in the hands of a holder in due course. (5 Uniform Laws Annotated, Sec. 124)

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[23] R., Sec. 295.
[24] *Phoenix Tempe Stone Co.* v. *De Waard*, 20 F. (2d) 757.
[25] *National Rys. Advertising Co.* v. *E. L. Bruce Co.*, 143 Ark. 292, 220 S. W. 48.
[26] R., Secs. 435 to 437 inclusive.
[27] *Post*, p. 353.

Merger. When one has rights under a contract and accepts rights of a superior nature in respect to the same subject matter and to the same parties, the former are discharged. This is known as a *merger,* because the lesser right is said to merge into the greater.[28] For example, when one brings an action on a contract and recovers judgment, his right of action under the contract is merged in the judgment or, as it is sometimes called, the "contract of record," which is of a higher nature.[29] It is sometimes stated, without strict accuracy, that a parol contract merges into a subsequent written contract in respect to the same matter. The reason for this is that courts presume that the parties have reduced all the terms of the oral agreement to writing and refuse to admit parol evidence to the contrary.[30] There is a merger, however, only when the written contract is the same as the parol contract. If the terms of the two contracts differ, the written contract is an accord and satisfaction or a rescission. Another example of a contract being discharged by merger is that in which the lease of a tenant is discharged by the acceptance of a conveyance of the immediate reversion.[31]

Bankruptcy. The bankruptcy laws operate as a practical discharge of contracts in most instances.[32] The effect of such laws, however, is not in fact a discharge, but merely a bar to a right of action. Thus, as such laws are only a bar to a right of action, and not a discharge, the bar may be waived so as to revive the right of action.[33]

> A discharge in bankruptcy does not bar a right of action for wages earned within three months before the petition in bankruptcy is filed due to workmen, servants, clerks, or traveling or city salesmen, or for money received or retained by an employer to secure faithful performance by an employee of the terms of a contract of employment. (United States Code, 1941, Title 11, Sec. 35)

Statutes of Limitations. In a few states contracts seem to be declared void by statute after the lapse of a given number

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[28] R., Sec. 443.
[29] *Oliver* v. *Holt,* 11 Ala. 574; see R., Sec. 444.
[30] R., Sec. 447.
[31] *Post,* p. 856; see also, R., Secs. 445 and 446.
[32] R., Sec. 385.
[33] *Ante,* p. 96.

of years. In most states the statutes merely provide that the right of action on a contract is barred if no action is brought within a specified time.[34] These statutes are known as the *Statutes of Limitations*. The period of time prescribed varies in the different states, and in the same state, according to the nature of the contract.

The following table shows for the various states, Alaska, and the District of Columbia the periods of time within which actions must be commenced:

State	Notes (Yrs.)	Open Accts. (Yrs.)	Judgments (Yrs.)	State	Notes (Yrs.)	Open Accts. (Yrs.)	Judgments (Yrs.)
Alabama	6	3	20	Montana	8	5	10
Alaska	6	6	10	Nebraska	5	4	5
Arizona	6	3	4	Nevada	6	4	6
Arkansas	5	3	10	New Hampshire	6	6	20
California	4	4	5	New Jersey	6	6	20
Colorado	6	6	20	New Mexico	6	4	7
Connecticut	6	6	No limit	New York	6	6	20
Delaware	6	3	10	North Carolina.	3	3	10
D. of Columbia.	3	3	12	North Dakota	6	6	10
Florida	5	3	20	Ohio	15	6	21
Georgia	6	4	10	Oklahoma	5	3	5
Idaho	5	4	6	Oregon	6	6	10
Illinois	10	5	20	Pennsylvania	6	6	20
Indiana	10	6	20	Rhode Island	6	6	20
Iowa	10	5	20	South Carolina.	6	6	20
Kansas	5	3	5	South Dakota	6	6	20
Kentucky	5	2	15	Tennessee	6	6	10
Louisiana	5	3	10	Texas	4	2	10
Maine	6	6-20	6-20	Utah	6	4	8
Maryland	3	3	12	Vermont	6	6	8
Massachusetts	6	6	20	Virginia	5	3	10
Michigan	6	6	10	Washington	6	3	6
Minnesota	6	6	10	West Virginia.	10	5	10
Mississippi	6	3	7	Wisconsin	6	6	20
Missouri	10	5	10	Wyoming	10	8	21

In some states the period of time within which an action must be commenced on a sealed, a witnessed, or a non-negotiable note is longer than that given in the foregoing table. In some cases also, the period for judgments includes the time for which a judgment may be renewed. Because any of these data may be changed at any session of the state legislature, this table is given merely as an illustration and not for reference. If an occasion arises when exact information is required, the statute of the particular state involved should be consulted.

[34] R., Sec. 385.

The statute starts to run at the moment that one gains the right of action, except when the party entitled to sue is under some disability. As in the case of bankruptcy, the bar may be waived.[35] In most states the waiver must be in the form of an express promise to pay, although an acknowledgment is sufficient when it implies a promise. In some states the promise must be in writing. Part payment of the principal or interest is also a waiver of the bar and revives the debt.

By Performance. A contract is discharged when its obligations have been performed. If the contract is unilateral, it is dissolved by performance on the part of the promisor, and if bilateral, by performance on both sides.[36]

Satisfaction of Promisor. When the agreement requires that the promisor of the performance of an act must perform such an act to the satisfaction of the promisor of payment, the performer must carry out the terms of the agreement, if they involve personal taste or judgment, to the satisfaction of the payer. To illustrate, when one promises to make clothes, to write a novel, or to paint a portrait to the satisfaction of the one who promises payment therefor, the agreement is not performed by the first party until the one promising payment is satisfied. The same rule applies in many states when the subject matter involves fitness or mechanical utility.[37] It seems, however, that the promisor is required to express his dissatisfaction in good faith. Other courts hold that when performance involving operative fitness or mechanical utility must meet the satisfaction of the promisor, it is sufficient if a reasonable man ought to be satisfied.[38]

> A contract was made for the construction of a public garage "to the entire satisfaction of the owners." During subsequent litigation, the court declared: "The words of the contract 'to the entire satisfaction of the owners' import that the construction shall be to the satisfaction of a reasonable man and not, as the plaintiffs contend, to the personal satisfaction of the owners." (MacDonald v. Kavanaugh, 259 Mass. 439, 156 N. E. 740)

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[35] R., Sec. 86.
[36] R., Sec. 386.
[37] *Blue* v. *Hazel-Atlas Glass Co.*, 106 W. Va. 642, 147 S. E. 22.
[38] R., Sec. 265.

Substantial Performance. At common law strict performance was required in order to recover for services against the promisor. In equity mere substantial performance was sufficient to recover the amount due on the contract, minus damages resulting from lack of complete performance. This doctrine has been followed at law by most courts, particularly in connection with building contracts, in order to avoid grave injustice.[39] Thus it is said that "when one has received the benefits of substantial performance by the other without paying the price agreed upon, and he cannot or does not return these benefits, it is manifestly unjust to permit him to retain them without paying, or doing as he promised." [40] It is necessary, however, that the defects be slight and immaterial, and not wilfully done, but that they result from an honest attempt made in good faith.

Time of Performance. In the absence of an express stipulation as to time, it is generally held that performance must be made within a reasonable time. When the time of performance is stipulated, the old rule was that performance must occur not later than the date named, on the ground that time is of the essence of the contract. Modern decisions, however, are inclined to hold to the contrary, unless there is an express promise or the terms or nature of the contract indicate clearly that time is of the essence, as in case of mercantile contracts.

> Late performance is not a breach which will discharge the other party, "unless the nature of the contract is such as to make performance on the exact day agreed upon of vital importance, or the contract in terms provides that it shall be so." (Restatement, Contracts, Sec. 276)

Payment.[41] Performance may consist of the payment of money or of the delivery of a negotiable instrument. In the latter case it will discharge the contract if the instrument is accepted in full satisfaction, but not if it is accepted conditionally upon its being paid. Unless expressly stipulated to

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[39] R., Sec. 275.
[40] *St. Charles* v. *Stookey*, 154 F. 772.
[41] For application of payments made by a debtor who owes two or more debts to the same person, see R., Secs. 387 to 394 inclusive.

the contrary, the acceptance of a negotiable instrument in payment is presumed to be conditional.

Tender of Performance. An offer to perform is known as a *tender*. If performance requires the doing of an act, a tender which is refused will discharge the party offering to perform. If, however, performance requires the payment of a debt, a tender which is refused does not discharge the obligation.[42] Its effect is to stop the running of interest and to prevent the collection of court costs when a party is sued, provided the tender is kept open and the money is produced in court.

> A debtor tendered the sum of $350.20 in payment of a debt. The tender was refused by the creditor. Thereafter the debtor deposited the sum of $160.89 with the clerk of the court. It was held that he had not kept the tender good. (Anderson v. Griffith, 51 Oreg. 116, 93 P. 934)

A valid tender of payment consists of an unconditional offer of the exact amount or an amount from which the creditor may take what is due without the necessity of making change. In the absence of a statute to the contrary, the debtor or his agent must ordinarily actually produce the money. Production of the money may, however, be waived by the creditor. For example, it is unnecessary for the debtor to produce the money after the creditor indicates that it will not be received.[43] The debtor must also offer *legal tender* currency, or, in other words, gold, silver, paper, or token money, which the creditor is required by law to accept.[44] Unless the objection to the kind of money tendered is specified at the time of refusal to accept, a tender of other lawful money is deemed valid.[45]

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[42] R., Sec. 415.

[43] *Steckel* v. *Selix*, 198 Iowa 339, 197 N. W. 918.

[44] A recent amendment to the statutes of the United States makes all coins and currencies of the United States (including Federal reserve notes and circulating notes of national banks) legal tender. This amendment changes the law in respect to the kinds of money deemed to be legal tender. Whether it changes the specific provision of an earlier statute in respect to the amount of token money deemed to be legal tender will not be known until the question is passed on by the Supreme Court. The specific provision declares that silver tokens are legal tender for the payment of any amount not exceeding $10, and that other tokens are legal tender for the payment of any amount not exceeding 25 cents in one payment.

[45] R., Sec. 305.

By Breach. A contract may be discharged by an acceptance of a breach occurring either before or after the other is entitled to performance. In the first case it is known as an anticipatory breach, which may take the form of an express renunciation, or an implied renunciation when the conduct of the obligor makes it impossible to perform. In the second instance the breach may take the form of mere nonperformance or of a repudiation.

Renunciation. When one party to an executory contract unqualifiedly repudiates his obligation, the promisee in most states is entitled to treat the contract as discharged.[46] This doctrine is based on the grounds that the promisee has a right to have the contract kept open as a subsisting and effective contract, and that the promisor impliedly undertakes that he will do nothing inconsistent with the contractual relation. Therefore, although technically an anticipatory repudiation is not a breach, "it may become so if accepted and acted on by the other party." [47]

> Generally speaking, one who seeks to rescind an agreement must promptly offer to return what he has received, but this is not always true, as, for example, when that which was received was "without value." (Continental Ins. Co. v. Equitable Trust Co., 127 Misc. 45, 215 N. Y. S. 281)

If the promisee does not elect to rescind the agreement, the contract continues in force, and his remedy is damages for breach at once or at the time of performance. After renunciation, however, the promisee cannot continue to carry out his part of the agreement, thus piling up damages. To illustrate, when some architects agreed to prepare preliminary drawings and to complete working drawings and specifications, and the other party repudiated the contract upon the completion of the preliminary drawings, the architects could not recover for their services in preparing the working drawings and specifications after the repudiation.[48]

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[46] R., Sec. 306.
[47] *Huessner* v. *Fishel & Marks Co.*, 281 Pa. 535, 127 A. 139.
[48] *Wetzel* v. *Rixse*, 93 Okla. 216, 220 P. 607.

> It is a general rule that in case of breach of contract the injured party must make reasonable efforts to prevent harm. If he fails to do so, and the harm is enhanced, he cannot recover "the amount of this avoidable and unnecessary increase." (Restatement, Contracts, Sec. 336 and Comm. d)

Incapacitating Self. Another form of anticipatory breach exists when the promisor renders it impossible to perform his obligation.[49] Under such circumstances the promisee is entitled to treat the contract as discharged. For example, when one who is bound by the terms of the contract to turn over bonds, stock, or notes, gives them to another, the promisee may elect to treat the contract as discharged.[50] The same is true when one agrees to sell specific goods to another and then sells them to a third party.

> " 'The act of a party in voluntarily placing it out of his power to perform a contract on his part, constitutes a breach thereof, for which an action may be brought, although the time for performance has not yet arrived under the terms of the contract.' 13 C. J. 650, Sec. 724." (Internal Water Heater Co. v. Burns Bros., 114 N. J. L. 368, 176 A. 380)

Nonperformance. Whether a breach by failure of performance will discharge a contract depends upon whether the promises are independent or conditional. In case of the former a failure to perform will not discharge the contract, and the only remedy of the other is damages. Promises are said to be independent when they are absolute, divisible, or subsidiary.

An absolute promise is one having for its consideration another promise and not the performance of such promise. In such a case nonperformance on one side does not discharge the contract, but merely gives the other a right of action for damages.

Divisible promises exist where the agreement consists of two or more parts and calls for corresponding performances by the parties of each part. Thus, in a promise to buy several

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[49] R., Sec. 284.
[50] *Lyle* v. *McCormick Harvesting Mach. Co.*, 108 Wis. 81, 84 N. W. 18.

separate articles at different prices at the same time, the agreement may be construed to be in effect divisible promises for each article.[51] Where it is so held, failure to perform part does not discharge the other party who is entitled only to sue for damages. When a contract calls for performance in installments, there has been a conflict in authority as to whether it is indivisible, so that a failure in one installment entitles the other party to rescind, or whether it is divisible, in which case he can only sue for damages.[52] According to the provisions of the Uniform Sales Act, the decision depends upon the terms of the contract and the circumstances of each case.[53]

> "'Divisible contract to sell or sale' means a contract to sell or a sale in which by its terms the price for a portion or portions of the goods less than the whole is fixed or ascertainable by computation." (Uniform Sales Act, Sec. 76)

When there is a failure to perform one of several terms of a contract, the agreement is not terminated unless such a term is vital to its existence, and a failure to perform such a term changes the nature of the remainder of the agreement.[54] A term which does not go to the root of the contract is a subsidiary term.

Remedies for Breach. There are three remedies for breach, of which one or more may be available to the injured party, when the promises have been broken by the other. The injured party is always entitled to bring an action for damages; in some instances, he may be exonerated from further performance; and in other circumstances, he may bring a suit in equity to obtain specific performance.

Damages. Whenever a breach of contract occurs, the innocent party is entitled to bring an action for damages.[55] He is under a duty, however, to mitigate the damages in an appropriate way. He may, for example, be required to stop per-

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[51] *Wooten* v. *Walters*, 110 N. C. 251, 14 N. E. 734.
[52] R., Sec. 317.
[53] *Post*, p. 587.
[54] R., Sec. 275.
[55] R., Sec. 327.

formance, or in an employment contract he may be required to seek other employment.[56]

When there is no actual loss, he is entitled to a judgment of a very small sum, such as six cents or one dollar, which is known as *nominal* damages.[57] When there is an actual loss, he is entitled to a sum of money that will, as far as possible, equal such loss. The parties may stipulate in the original agreement the payment of a certain sum in case of default. This amount is known as *liquidated* damages, and it will be enforced if it is not excessive.[58]

As a general rule, vindictive or exemplary damages cannot be recovered; nor can damages be recovered for remote injuries. What constitutes remote injuries will depend largely upon the facts of each case.[59] "The damage which a party ought to receive in respect to such breach of contract may be said to be such as may fairly and reasonably be considered either arising naturally—that is, according to the usual course of things—from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract, as the probable result of the breach of it." [60]

Rescission. The injured party may also have the right to elect to treat the contract as discharged. When he is justified in rescinding the agreement, he is under no obligation of further performance. A common circumstance which will entitle him to rescind is a failure to receive substantially the performance for which he bargained. If the injured party exercises the right of rescission after performance on his part, he may also recover, on an implied contract, the value of the services rendered.[61]

> A father agreed to make no will in return for certain services performed by his daughter. He died leaving a will in violation of the agreement. The daughter was entitled to rescind the contract and recover the value of her services. (Downey v. Guifoile, 96 Conn. 383, 114 A. 73)

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[56] *Post*, p. 202.
[57] R., Sec. 328.
[58] R., Sec. 339.
[59] R., Sec. 330.
[60] *Miholevich* v. *Mid-West Mut. Auto Ins. Co.*, 261 Mich. 495, 246 N. W. 202.
[61] R., Sec. 498.

Specific Performance. Under special circumstances the injured party may seek the aid of the court of equity to compel the other to carry out the terms of his obligation. This is known as *specific performance.* The granting of this form of relief is discretionary with the court.[62] A petition will be denied, first, when it works an undue hardship and injustice to the other party; second, when the court is unable to supervise such acts;[63] third, when the agreement is illegal, fraudulent, or immoral;[64] and, fourth, when there is an adequate remedy in damages.[65]

As a general rule, contracts for the purchase of land will be enforced.[66] This is because the value thereof, depending upon the soil, place, character, and other elements attractive to a purchaser, cannot be determined with sufficient accuracy to give adequate damages in a court of law. On the other hand, specific performance of a contract to sell personalty is usually denied, for the buyer can ordinarily purchase the goods elsewhere, and his damages are easily computed. In some cases, however, the goods cannot be purchased elsewhere or there is a peculiar value attached to the particular articles sold, or the articles possess an unusual age, rarity, beauty, unique history, or other distinction, as in the case of heirlooms, original paintings, old editions of books, or relics. Under these circumstances a contract to sell would ordinarily be specifically enforced, because it would be difficult to determine the value, and estimated damages would not fully compensate the injured party.[67] Thus, in case of a contract to sell shares of stock, essential for control of a close corporation, having no fixed or market value and not being quoted in the commercial reports or sold upon the stock boards, the court declared: "In such circumstances an action for damages would not afford adequate relief; hence a suit for specific performance will lie." [68]

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[62] R., Sec. 359.
[63] R., Sec. 371.
[64] R., Sec. 367.
[65] R., Sec. 358.
[66] R., Sec. 360.
[67] R., Sec. 361.
[68] *Johnson* v. *Johnson*, 87 Colo. 207, 286 P. 109.

QUESTIONS

1. A shipowner agreed to make a voyage for a charterer of his vessel. The agreement was, however, subject to a condition that the vessel was not destroyed by fire, collision, or other dangers of the sea. Before the time of performance, the vessel was in a storm at sea and was cast upon some hidden reefs. As a result, the ship was totally destroyed. In an action brought by the charterer against the shipowner, it was contended that the contract had terminated. Was this contention sound?

2. John H. Perlee and Robert C. Jeffcott entered into an agreement for the purchase and the sale of a barn. Before the time for performance, the barn was struck by lightning and was totally destroyed. In an action brought by Perlee against Jeffcott for breach of contract it was contended that the contract was terminated by impossibility. Was this contention sound?

3. Klagger and Besse entered into an agreement. Later they and Fisher, by agreement, substituted Fisher for Besse. Was the second transaction a novation?

4. Groves agrees to give Hitter an automobile in satisfaction of a right of action which the latter has against him. Before Groves delivers the automobile, Hitter brings action against him. Groves pleads that Hitter has agreed to accept an automobile in satisfaction of his right of action. Is this a valid defense?

5. J. B. Lewis entered into an agreement with the United States to construct certain levee work on the lower Mississippi river. Because of a flood Lewis was unable to build the levee as agreed. In an action brought by the United States, Lewis contended that the contract was discharged by impossibility. Do you agree with this contention?

6. Shoule agreed to sell to Mitchell all of the apples grown in his orchard. He was unable to deliver any apples because a frost ruined the apple crop. Was Shoule liable to Mitchell for breach of contract?

7. Richlieu and Cooney are discussing the termination of contracts by operation of law. The former maintains that a contract is discharged when the promisor is judicially declared to be a bankrupt. Cooney maintains that this is not true. Do you agree with Richlieu or Cooney?

8. A statute prescribes that no action shall be brought on debts later than six years after they are due. Seven years after a debt owed by Klopp to Surrell is due and payable, the former makes a part payment. Six months later Surrell sues Klopp for the remainder of the obligation. Klopp pleads the Statute of Limitations. Is this a valid defense?

9. Mikadoo agrees to act as Mellon's agent for one year. Six months later Mikadoo dies. Mellon sues Mikadoo's personal representative for breach of contract. Is the estate of the deceased liable for damages?

10. Kropper agrees to repair the plumbing in Kingsley's house. Kingsley refuses to let Kropper enter his house and later sues him for breach of contract. Is Kingsley entitled to damages?

CASES FOR REVIEW

1. Frank Shaw wired at 11:30 A.M. to William W. Brauer, offering to rent all the cattle-carrying space on the Warren Line steamships for the May sailings from Boston, Massachusetts, to Liverpool, England. The offer was received by the offeree at 12:16 P.M. At 12:28 Brauer telegraphed an acceptance, which did not reach Shaw until 1:20 P.M. At 1 P.M., however, Shaw had wired a revocation of the offer. The withdrawal of the offer was received by Brauer at 1:43 P.M. Shaw failed to perform, and Brauer brought an action to recover damages arising out of breach of contract. Was he entitled to judgment? (Brauer v. Shaw, 168 Mass. 198, 46 N. E. 617)

2. Henry S. Magoon was sitting in his office when Richard H. Reber entered and handed him a promissory note. Reber directed Magoon to sign the note. When Magoon questioned the proceedings, Reber pressed a pistol to his head and told him to sign the instrument quickly. Magoon complied but thereafter sought to avoid liability to Reber on the note. Was he entitled to do so? (Magoon v. Reber, 76 Wis. 392, 45 N. W. 112)

3. Edward Saxon, of Nashville, Tennessee, executed a written instrument whereby he promised to teach the pupils that Anna C. Goff, of the Arts Club, Lexington, Kentucky, assigned to him for instruction. By the same instrument Miss Goff became bound to assign to Saxon for instruction such students as she desired. Thereafter Miss Goff brought an action against Saxon to enforce the promise that he had made. Was she entitled to judgment? (Goff v. Saxon, 174 Ky. 330, 192 S. W. 24)

4. Theodore Weiss, a small retail dealer in Pennsylvania, offered to sell Peter Theiss 20,000 barrels of flour at $4 a barrel. The price was considerably below the market price, and Theiss accepted the offer. Weiss had in fact made the offer only in jest and refused to perform as agreed. Theiss brought an action against Weiss to recover damages arising out of breach of contract. Was Theiss entitled to judgment? (Theiss v. Weiss, 166 Pa. 9, 31 A. 63)

5. R. A. Lazenby was the chief beneficiary of a will executed by R. H. P. Lazenby. After the death of the testator, the heirs-at-law sought to have the will set aside. R. A. Lazenby entered into an agreement whereby he promised to pay a certain sum of money to A. M. Lazenby in return for the suppression of certain evidence in connection with the contest of the will. Thereafter A. M. Lazenby brought an action to enforce the promise made by R. A. Lazenby. Was he entitled to judgment? (Lazenby v. Lazenby, 132 Ga. 836, 65 S. E. 120)

6. Rich, an infant, borrowed a sum of money from Kilgore. The loan was made by Kilgore paying a board bill that Rich had incurred while attending school. Thereafter Kilgore brought an action in Waldo County, Maine, to recover the money he had lent to Rich. Was he entitled to judgment? (Kilgore v. Rich, 83 Me. 305, 22 A. 176)

7. Peter Katus entered into an oral agreement with the Cooperative Telephone Company of Detroit, Michigan. Under the terms of the agreement Katus promised to rent a telephone for a period of three years at a stipulated rental. Katus signed the agreement, but the company did not do so. During subsequent litigation it was contended that the company was not bound. Do you agree? (Cooperative Tel. Co. v. Katus, 140 Mich. 367, 103 N. W. 814)

8. Calvin C. Deaton, of Seattle, Washington, entered into a contract with O. V. Lawson whereby he was to receive certain medical treatments in return for the payment of a specified fee. Deaton refused to accept performance of the agreement by a physician who was employed by Lawson. Was his action legally justifiable? (Deaton v. Lawson, 40 Wash. 486, 82 P. 879)

9. P. J. Quigley was a section foreman in the employ of the Northern Pacific Railway Company. He made an assignment to his daughter of his wages to be earned under his contract for a period of six months in return for her care of his other minor children. Notice of the assignment was not given to the railway company. During litigation between the daughter and a creditor of her father, it was contended that the foregoing assignment was not valid. Do you agree? (Quigley v. Welter, 95 Minn. 383, 104 N. W. 236)

10. The Capitol City Brick Company entered into an oral agreement with the Atlantic Ice & Coal Company for the purchase and the sale of 500,000 bricks at $6 a thousand. Thereafter the Atlantic Ice & Coal Company signed a memorandum of the agreement. When the Atlantic Ice & Coal Company failed to carry out the agreement, the brick company brought an action to recover damages arising out of breach of contract. The Atlantic Ice & Coal Company pleaded as a defense the Statute of Frauds. Was the brick company entitled to judgment? (Capitol City Brick Co. v. Atlantic Ice & Coal Co., 5 Ga. A. 436, 63 S. E. 562)

11. J. W. Hunt, who was born on September 6, 1882, was a member of the Quapaw Tribe. He received an allotment of two hundred acres of land located in northeastern Oklahoma. On September 5, 1903, Hunt executed a lease of his land for a period of ten years to Willis Wright, J. C. Haskett, and A. J. Crawford. Thereafter in an action brought by the United States, it was contended that the agreement was not binding on Hunt. Do you agree? (United States v. Wright, 197 F. 297)

12. James Philip, as administrator of the estate of Frank Porter, brought an action against Royal V. Stearns and others. The action was based upon a written instrument having the word "Seal" after the signature of Stearns, who had executed the agreement. It was contended that the instrument was not a contract under seal. Do you agree? (Philip v. Stearns, 20 S. D. 220, 105 N. W. 467)

13. Five men, including L. P. Jensen, of Sleepy Eye, Minnesota, entered into an agreement to form at a specified date a limited partner-

ship to engage in business in the city of Chicago under the name of Whiteside, Farrel & Company. Before the date of performance, Jensen died. During subsequent litigation in respect to the contributions of the parties to the enterprise, it was contended that the foregoing contract had been terminated. Was this contention sound? (Dow v. State Bank of Sleepy Eye, 88 Minn. 355, 93 N. W. 121)

14. George W. Green, as executor of the estate of B. S. Kenyon, had a farm to sell. He orally agreed to pay the Reynolds-McGinness Company, real estate brokers, a certain sum for making a sale of the property for $6,000. After making the sale, the company sued Green personally to recover the agreed compensation. Was it entitled to judgment? (Reynolds-McGinness Co. v. Green, 78 Vt. 28, 61 A. 556)

15. M. S. Cobb was appointed a deputy prosecuting attorney in Garland County, Arkansas, under an agreement with the prosecuting attorney, W. T. Scoggins. The agreement provided that Cobb would be paid more compensation than was provided by law. After being discharged, Cobb brought an action against Scoggins to enforce the agreement. Was Cobb entitled to judgment? (Cobb v. Scoggins, 85 Ark. 106, 107 S. W. 188)

16. Harry Morley became indebted to J. Hoeven, of Sioux City, Iowa. Hoeven agreed to extend the time of payment of the debt until the following spring, provided that Morley accepted employment with a stock yard company in the city of Sioux Falls, South Dakota. Morley had previously accepted employment with the company. Hoeven later refused to carry out his promise. Was he legally justified in so doing? (Hoeven v. Morley, 36 S. Dak. 421, 155 N. W. 191)

17. J. W. McClelland bought certain land in Los Angeles County, California. Although he inspected the land, he made the purchase relying upon the statement of Unreh, the agent of the seller, that the property was good orange land, would raise oranges, and make McClelland a good living. Thereafter an action was brought to recover the amount of a deferred payment that McClelland refused to pay because the statements of Unreh proved to be untrue. Was the plaintiff entitled to judgment? (Lee v. McClelland, 120 Calif. 147, 52 P. 300)

18. Dobbins, who was engaged in the nursery business in Montgomery County, Iowa, sold and delivered to Childs, an infant, certain trees and shrubbery. Childs paid Dobbins the sum of $500 for the goods. Thereafter, but before reaching majority, Childs disaffirmed the agreement and brought an action by his next friend to recover the money paid to Dobbins. Was he entitled to do so? (Childs v. Dobbins, 55 Iowa 205, 7 N. W. 496)

19. James Helber took his automobile to a garage in Ypsilanti, Michigan. Theodore E. Schaible and another, owners of the garage, contended that Helber had left his machine with them for repairs, although there had been no agreement as to compensation. If the con-

tention was true, did the parties make an express contract? (Helber v. Schaible, 183 Mich. 379, 150 N. W. 145)

20. The Triangle Waist Company entered into an agreement to employ Beatrice Todd as a designer for a period of one year at a salary of $45 a week. Thereafter the parties entered into a contract of employment for the same period of one year, fixing the salary of the designer at $100 a week. In an action brought by the Triangle Waist Company against Miss Todd, it was contended that the first contract between the parties had been terminated. Do you agree? (Triangle Waist Co. v. Todd, 168 App. Div. 693, 154 N. Y. S. 542)

21. R. L. Theus purchased from W. H. Harris certain leases of pine land and erected a distillery for the manufacture of turpentine. As part of the transaction, Harris agreed that he would not engage in the business of manufacturing turpentine within ten miles of the town of Geneva, Alabama, so long as Theus was in business in that town. Thereafter Theus brought an action against Harris to enforce the promise. Was Theus entitled to judgment? (Harris v. Theus, 149 Ala. 133, 43 S. 131)

22. Mann recovered a judgment against Tillet, who thereafter obtained certain land in Colorado from the United States. A Federal statute declared that such land was not liable for the satisfaction of "any debt contracted prior to the issuance" of the patent for the land. In an action brought by the administratrix of the estate of Tillet, Mann argued that his claim was not barred by the statute. He contended that the judgment was not a contract. Do you agree with this contention? (Brun v. Mann, 151 F. 145)

23. On July 22 the H. Michelson Company mailed a letter to the Stein-Gray Drug Company, of Cincinnati, stating in reference to Puerto Rico bay rum: "Our quotation to you was 75¢ per gallon in bbl. lots; but we have decided to make a flat price of 70¢ per gallon in bbl. lots to jobbers." The Stein-Gray Drug Company upon receipt of the letter wired in return: "Accept offer twenty-second." When delivery of the bay rum was refused, the Stein-Gray Drug Company brought an action against the H. Michelson Company to recover damages arising out of breach of contract. Was it entitled to judgment? (Stein-Gray Drug Co. v. H. Michelson Co., 132 App. Div. 90, 116 N. Y. S. 789)

24. C. F. Cannon entered into an oral agreement whereby he promised to marry Ila Coggins at some indefinite time. Thereafter he refused to carry out his promise. Miss Coggins brought an action against Cannon to recover damages arising out of breach of contract. Was she entitled to judgment? (Coggins v. Cannon, 112 S. C. 225, 99 S. E. 823)

25. Charles F. Buck was a dealer in dry goods, clothing, and shoes in Hortonville, Wisconsin. By mistake he ordered 2,500 needle cards from J. A. Coates & Sons, Limited, a company engaged in a manufacturing and wholesale business in New York City. Unknown to the seller

when accepting the offer, Buck had really desired to purchase only 500 papers of needles. When the delivery of the needle cards ordered was refused, the seller brought an action against Buck to recover under the contract of sale. Were the sellers entitled to judgment? (J. A. Coates & Sons v. Buck, 93 Wis. 128, 67 N. W. 23)

26. George A. Schick and his partner entered into an agreement with James Speliopoulos whereby they promised to maintain a bootblacking stand alongside a building in the city of Milwaukee, Wisconsin. Thereafter a city ordinance declared it to be illegal to maintain such a structure on the street. Speliopoulos brought an action against the partners to recover damages arising out of breach of contract. Was he entitled to judgment? (Speliopoulos v. Schick, 129 Wis. 556, 109 N. W. 568)

27. Phoebe W. Hoffman owned a ground rent from certain premises located on Lombard Street in Philadelphia, Pennsylvania. She entered into an agreement for the sale of the ground rent to Nathan T. Clapp. The buyer entered into the agreement under the belief that the ground rent was irredeemable. It was discovered later that the ground rent was as a matter of law redeemable. During subsequent litigation, the executors of the estate of Nathan T. Clapp contended that the agreement was not binding. Do you agree? (Clapp v. Hoffman, 159 Pa. 531, 28 A. 362)

28. Joseph P. Morgan was about to bring an action to recover a debt owed to him by Anthony Farrari. He agreed to forbear bringing the action for a specified time in return for the promise of Anthony Corletto to pay the amount of money owed by Farrari. Thereafter Morgan sought to enforce the promise of Corletto. Was he entitled to do so? (Corletto v. Morgan, 27 Del. 530, 89 A. 738)

29. William J. Beeman, an infant, purchased from James Lemon a certain stock of drugs, located in a store in Illinois, for which he paid the sum of $400. Thereafter Beeman lost the goods. Upon reaching majority, Beeman brought an action in Sandusky County, Ohio, to recover the money he had paid to Lemon for the goods. Was he entitled to judgment? (Lemon v. Beeman, 45 Ohio St. 505, 15 N. E. 476)

30. Patrick Bambrick, a resident of St. Louis, Missouri, died, leaving a widow, Rose Bambrick. At the time of his death he owed a certain sum of money to John Bambrick for money lent and goods supplied on credit. Thereafter John Bambrick brought an action against Mrs. Bambrick personally to recover the debt. He alleged that after being appointed executrix of the estate of her husband, she had orally agreed to pay to him "every dollar her husband owed." Was he entitled to judgment? (Bambrick v. Bambrick, 157 Mo. 423, 58 S. W. 8.

31. Herbert D. Wellington owed the sum of $7,000 to Earl M. Cranston. He transferred certain land to George A. Starbird and Frank B. Davis, who in return therefor promised to pay to Cranston the amount of the debt owed by Wellington. Was Cranston entitled to enforce the

agreement made by Wellington with Starbird and Davis? (Starbird v. Cranston, 24 Colo. 20, 48 P. 652)

32. Samuel Galey, who had no special knowledge, skill, or ability for drilling wells, entered into a contract to drill an oil well in Pennsylvania for W. L. Mellon. Thereafter he entered into an agreement whereby A. G. Smith and another undertook to drill the well for him. Did this constitute an assignment? (Galey v. Mellon, 172 Pa. 443, 33 A. 560)

33. John E. Sullivan was the former president of a corporation that went into the hands of a receiver. Certain books that were material to an investigation of the corporate affairs by a court were missing. Sullivan made a public offer of $100 for the return of the books. Florence R. Phillips found and returned the books without knowledge of the offer of reward. Sullivan sent her the sum of $5. Thereafter Miss Phillips brought an action against Sullivan to recover $95. Was she entitled to judgment? (Sullivan v. Phillips, 178 Ind. 164, 98 N. E. 868)

34. Jones and Surprise entered into an agreement for the sale and the purchase of certain liquors. A statute of the state at this time prohibited the sale of liquors. When the parties subsequently engaged in litigation, it was contended that the foregoing agreement was void. Was this contention sound? (Jones v. Surprise, 64 N. H. 243, 9 A. 384)

35. John F. Lyford conveyed his farm, located in St. Albans, Maine, to Charles H. Brawn. He also assigned to Brawn a policy of insurance against loss of the buildings on the land by fire. It was later discovered that the assent of the insurance company was necessary for a valid assignment of the policy. Lyford promised Brawn that he would send in the policy for such assent, but he failed to do so. A fire, started by lightning, destroyed the buildings. Brawn brought an action against Lyford to recover damages arising out of breach of contract. Was he entitled to judgment? (Brawn v. Lyford, 103 Me. 362, 69 A. 544)

36. Jacob W. Deal entered into an oral agreement to perform certain services for George Wilson, of Catawba County, North Carolina. Deal performed the services, but Wilson refused to perform as agreed on the ground that the agreement was within the Statute of Frauds. If Wilson's stand was legally correct, was Deal without a remedy in a court of law? (Deal v. Wilson, 178 N. C. 600, 101 S. E. 205)

37. An ordinance required any person selling intoxicating liquors in Plumas County, California, to obtain a license. A. Pezzalo, an alien who could not obtain a license, began selling such beverages without a license. He entered into an agreement with H. Scheeline and others for the purchase and the sale of certain liquors. Was the agreement enforceable? (Scheeline v. Pezzalo, 29 Calif. A. 266, 155 P. 127)

38. Frank Lee, an infant from the island of Trinidad, was a student at Yale University. He leased a room from Mary E. Gregory in

New Haven County, Connecticut, for a period of forty weeks at an agreed rate of $10 a week, payable weekly. At the end of fourteen weeks Lee gave up the room and paid for the time he had occupied the room. Thereafter Mrs. Gregory brought an action to recover the rent for the remainder of the agreed period. Was she entitled to judgment? (Gregory v. Lee, 64 Conn. 407, 30 A. 53)

39. John Holland orally agreed to convey to Catherine Meyers a one-third interest in certain land, located in Orange County, Indiana. Thereafter he refused to carry out his promise. Mrs. Meyers brought an action against the heirs-at-law of Holland to enforce the promise. Was she entitled to judgment? (Jackson v. Meyers, 120 Ind. 504, 22 N. E. 90)

40. The Georgia Fruit Growers Exchange, of Atlanta, Georgia, entered into an agreement with D. C. Turnipseed, of Penrode, Alabama. The agreement was made in Georgia, where a statute prohibited such agreements. The Georgia Fruit Growers Exchange later brought an action against Turnipseed. Was the plaintiff entitled to enforce the agreement? (Georgia Fruit Growers Exch. v. Turnipseed, 9 Ala. 123, 62 S. 542)

41. John H. Schwerdt promised to pay $1.50 a week as his share in the support of his father, John C. Schwerdt. The promise was made in writing to the father, but without any valuable consideration as distinguished from good consideration being given therefor. Thereafter the father brought an action against his son to recover damages arising out of breach of contract. Was he entitled to judgment? (Schwerdt v. Schwerdt, 235 Ill. 386, 85 N. E. 613)

42. Lucillius Price, J. E. Ritchy, and Joel Buttles conveyed to George Clemmer, an infant, a tract of land located about twelve miles from Millet, Texas, and received in payment a note for the sum of $800. After the lapse of a reasonable period of time following his majority, Clemmer attempted to avoid the transaction. Was he entitled to do so? (Clemmer v. Price, 59 Tex. Civ. A. 84, 125 S. W. 604)

43. Henry Louderman promised in writing to pay the sum of $269.52 to Henry Judy. In return for the promise, Judy surrendered a note that had been executed by Louderman's son, Jesse. At the time, however, the note was an instrument on which no one was liable, because Jesse had died insolvent some time previously and his estate had been settled. Thereafter Judy brought an action against Nathan Louderman, as executor of the estate of Henry Louderman, to recover the sum promised. Was he entitled to judgment? (Judy v. Louderman, 48 Ohio St. 562, 29 N. E. 181)

44. Henry M. Whitney wrote on May 16 to William R. Park, offering to purchase certain shares of stock in a given corporation at any time after the following January 1. About fourteen months later Park wrote to Whitney, accepting the foregoing offer. Whitney refused to accept

and pay for the stock. Thereupon Park brought an action against Whitney to recover damages arising out of breach of contract. Was he entitled to judgment? (Park v. Whitney, 148 Mass. 278, 19 N. E. 161)

45. J. W. Murphy was a man of eighty-six years of age, of impaired faculties, and of enfeebled powers. At such time he executed a promissory note for $2,300. He did so at the solicitation of a close friend, who aroused and excited his prejudices against inheritable wealth by appealing to his religious and charitable instincts. His friend also falsely represented that he was giving his time to religious and educational work without compensation. After Murphy's death, it was contended that the friend to whom the note was payable was not entitled to enforce the promise. Do you agree? (Geddes v. McElroy, 171 Iowa 633, 154 N. W. 320)

46. Simon McDonnell and John J. Rigney entered into an agreement whereby McDonnell, for a promised consideration, agreed to appear at meetings of persons solicited to become buyers of real estate, to pretend to become a buyer of certain lots, and to talk to others with a view of inducing them to become purchasers of tracts of land. Thereafter McDonnell brought an action against Rigney to recover the promised compensation. Was he entitled to judgment? (McDonnell v. Rigney, 108 Mich. 276, 66 N. W. 52)

47. Hopkins and Woodson entered into an agreement that was held by the Supreme Court of Mississippi to be illegal. Under the terms of the agreement Woodson received from Hopkins certain personal property. Thereafter Hopkins brought an action to recover from Woodson the personal property that had been turned over to him. Was he entitled to judgment? (Woodson v. Hopkins, 85 Miss. 171, 37 S. 1000)

48. J. R. Warren & Company was a mercantile firm doing business in the city of Montgomery, Alabama. The firm allegedly received the sum of $500 that rightfully belonged to Thomas M. Barnett. If the allegation was true, did Barnett have a contractual remedy by which he could recover the money from the company? (Barnett v. Warren, 82 Ala. 557, 2 S. 457)

49. The Valley Planting Company entered into an oral agreement whereby it promised a specified compensation to John Wise for superintending the gathering of a year's crop on a plantation in Drew County, Arkansas. Thereafter Wise was discharged without cause. He brought an action against the company to recover damages arising out of breach of contract. Was he entitled to judgment? (Valley Planting Co. v. Wise, 93 Ark. 1, 123 S. W. 768)

50. John F. Rowan and others entered into a contract with A. L. Fullenwider at Jacksonville, Alabama. The agreement provided that they would convey certain land to Fullenwider within the next sixty days and that Fullenwider would at such time pay to them the sum of $19,500. When Fullenwider brought an action for failure to perform

the agreement, a question arose as to whether the agreement constituted an executed contract. What is your opinion? (Fullenwider v. Rowan, 136 Ala. 287, 34 S. 975)

51. John F. Shuford offered to sell a Whipp crank shaper machine to the State Machinery Company. The Nutmeg State Machinery Corporation accepted the offer and brought an action for breach of contract. Was it entitled to judgment? (Nutmeg State Mach. Corporation v. Shuford, 129 Conn. 659, 30 A. [2d] 911)

52. R. D. Jones made a revocable offer to make a contract for extended insurance. After Jones had died, the company accepted the offer. During subsequent litigation, it was contended that no agreement had been formed. Do you agree? (Jones v. Union Cent. Life Ins. Co., 265 App. Div. 388, 40 N. Y. S. 74)

53. Irving Hill offered Charles Mehrton the right to sell at any time within fifty years the sand and gravel from certain land. No consideration was given for the offer. Was Hill entitled to withdraw the offer before it had been accepted? (Podesta v. Mehrten, 57 Calif. A. 66, 134 P. [2d] 38)

54. The sellers of a furniture business in Washington, D. C., agreed that the buyer should have the exclusive right to use the name of Hilda Miller, Inc., and that they would not engage in the furniture business within the District of Columbia for a period of ten years. Was this agreement valid? (Hartung v. Hilda Miller, Inc., 133 F. [2d] 401)

55. J. B. Williams made a contract with several persons, whereby he undertook a performance which was for the benefit of one Paxton, a donee beneficiary. The promise of Williams was not enforceable by the promisees who were unable to perform on their part as agreed. Was Paxton entitled to enforce the promise of Williams? (Williams v. Paxton Coal Co., 346 Pa. 468, 31 A. [2d] 69)

56. The owner of an apartment house in Cheyenne, Wyoming, made a contract to pay a realty company a specified commission if a sale of the property was effected before the end of the year. Before the period of the contract had expired, the parties mutually agreed to cancel the contract. It was later contended that the first contract had terminated. Do you agree? (Wallick v. Eaton, 110 Colo. 358, 134 P. [2d] 727)

57. B. B. Hill offered $350 cash for a warranty deed to certain land located in Vermont. The offeree accepted the offer as to the cash sum, but stated that she would give a quitclaim deed to the property. During subsequent litigation, it was contended that no agreement had been formed. Do you agree? (Hill v. Bell, 111 Vt. 131, 11 A. [2d] 211)

58. A vendee of real estate, an educated person, without fault of the vendor merely "half-read the contract." As the result she failed to note a provision for eight per cent interest on installments from date of the contract. Did the mistake of the vendee as to the contents of the written contract affect the validity of the document? (Morrison v. Roberts, 195 Ga. 45, 23 S. E. [2d] 164)

CHAPTER II

PRINCIPAL AND AGENT

Part I—General Considerations

Introduction. One of the most important and useful devices in modern industrial society is agency. The economic structures of today have developed and now rest upon the doctrine that one person may act for and in the place of another. The affairs of the business world are conducted upon such a broad, elaborate, and complicated scale that few transactions can be accomplished entirely by means of individual efforts. The modern businessman, either because of the magnitude of his enterprise or because he is engaged in many distinct adventures, may be required to act in several widely separated places at the same time. It would be impossible to perform these duties except for the device termed *agency*, which permits one to act through representatives.

The law of agency, as it is known today, is of comparatively recent origin and development. Formerly the questions arising in connection with this relation were treated under the subject of master and servant. In many respects the two relations are similar, and the duties and liabilities of the servant and agent are the same. They differ, however, in many instances because of the nature of the relation; hence a separate treatment of the relation of agency is deemed desirable.

Generally speaking, all persons in the business world come in contact with the relation of agency. Practically every one is in the position of either principal or agent, or transacts business with persons who represent and act for another. It is therefore necessary that everyone engaged in business have some appreciation of the rules and principles governing the relation. He should have some knowledge of the legal principles involved in the creation of agency, the extent of the agent's powers, the duties and liabilities of the agent and the principal to each other, the liability of the principal to third persons, and the termination of the relation.

Definition. *Agency* is a relation based upon an express or implied agreement whereby one person is authorized to act for another in business transactions with third parties.[1] In a broad sense, it includes every relation in which one acts for another; but, as used here, "agency means delegated authority, and always implies some trust or confidence in the exercise of that authority." [2] The one who acts for another is described as an *agent*. The one for whom the act is performed is described as the *principal*.

> If a person represents another in contractual bargains, transactions, or negotiations involved in business dealings with third persons, or in hearings and proceedings, "he is termed an 'agent' and the person for whom he is to act is termed the 'principal.'" (Burlington Sav. Bank v. Prudential Ins. Co., 206 Iowa 475, 218 N. W. 949)

Agency is a consensual relation and cannot exist unless one person has by words or conduct indicated that he may be represented by another.[3] In a few instances, where the agent acts gratuitously, one of the elements of a contract may not be present, but in all cases there is an agreement expressed or implied.[4] The authority is sometimes said to be created by operation of law, but in these situations the relation either does not exist or may be implied in fact.

> "For while not necessarily contractual, the relation of agency is always consensual. Restatement A. L. I. Agency, Sec. 2." (Lohmuller Bldg. Co. v. Gamble, 160 Md. 534, 154 A. 41)

The term *agency* is frequently used with other meanings. It is sometimes used to denote the fact that one has the right to sell certain products, as a dealer who is said to possess an automobile agency. In other instances the term is used to mean an exclusive right to sell certain articles within a given territory. In these instances, however, the dealers are not agents in the sense of representing the manufacturers. The term is also used in the sense of a device or instrumentality

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[1] Restatement of the Law of Agency (hereinafter cited as R.), Sec. 1.
[2] *Fulton* v. *Walters*, 216 Pa. 56, 64 A. 860.
[3] R., Sec. 15.
[4] R., Sec. 16.

by which a given act is performed. In some cases the term *agency* is used to mean merely a place of business, as where a statute declares that a corporation or other company may be sued in the county in which it has its agency. In none of these instances, however, is anyone representing another; hence these meanings are not the meaning of agency in law.

Who May Be a Principal. Any person, if he is competent to act for himself, may act through an agent.[5] In general, whether one may be a principal depends upon the absence of legal or natural incapacity. To illustrate, the appointment of an agent by an infant is usually held to be void. In this respect, however, some states adopt a better rule, holding that such appointments are merely voidable, as in the case of other ordinary contracts.[6]

> A helplessly insane man executed a power of attorney, authorizing his partner to take general control over his affairs and business. It was held that the power of attorney was void because of the mental incapacity of the maker. (McClun v. McClun, 176 Ill. 376, 52 N. E. 928)

Groups of persons may also appoint agents to act for them. For example, Lane, Dexter, and Hall, having formed a partnership, may employ an agent to act for them in the transaction of the business of the firm.[7] Limited partnerships may also act by agents. Certain groups of persons, on account of the nature of the organizations, must ordinarily act through representatives. Thus a private corporation may enter into a contractual obligation only through the act of an agent.[8]

Who May Be an Agent. Anyone except a very young child or one whose mind is seriously deranged, as an idiot, may be an agent.[9] It is, of course, frequently unwise to use some persons as agents; but, as the principal is the one bound by the act of the agent, there is no reason for the law to limit his choice. It is therefore permissible to employ as agents

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[5] R., Sec. 20.
[6] *Courselle* v. *Weyerhauser*, 69 Minn. 328, 72 N. W. 697.
[7] *Clark* v. *Slate Valley R. R. Co.*, 136 Pa. 408, 20 A. 562.
[8] *Moyer* v. *East Shore Terminal Co.*, 41 S. C. 300, 19 S. E. 651.
[9] R., Sec. 21.

aliens, infants, and others under a natural or legal disability. For example, a married woman at common law could act for and in behalf of another, although she could not act for herself.[10] Collections of persons, as partnerships and corporations, may also act as agents. An illustration of groups frequently organized for the express purpose of acting as agents is the trust company.[11]

> O. W. Underwood authorized the firm of Wilgus & Bro., a partnership, to act for him in the sale of his real estate. The firm made a contract for the sale of the real estate to Deakin. Underwood was bound by the act of the firm. (Deakin v. Underwood, 37 Minn. 318, 33 N. W. 318)

There are some situations, however, in which a person who might ordinarily act as an agent is disqualified to act in that capacity. Situations of this kind arise when the law requires certain types of agents to possess specific qualifications, as in the case of attorneys at law, auctioneers, and realtors. They may also arise when the agent has some interest in the transaction which is adverse to the interests of the principal. To illustrate, a person cannot act secretly for the buyer as well as for the seller, for in such a case his interest would be adverse to the interest of either the buyer or the seller as principal.[12]

Classification of Agents. Agents usually are divided into classes in terms of the extent of the business to be transacted. In accordance with a division upon this basis, agents may be classified as special, general, and universal.[13]

Special Agents. These are agents authorized by the principal to transact definite business affairs or to do specific acts. Such an agent is one who is authorized by another to purchase a particular house for him. In other words, "a special agent is one authorized to act only in a specific transaction." [14]

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[10] *Pullman* v. *State*, 78 Ala. 31, 56 Am. Rep. 21.
[11] *Killingsworth* v. *Trust Co.*, 18 Oreg. 351, 23 P. 66.
[12] *Ferguson* v. *Gooch*, 94 Va. 1, 26 S. E. 397.
[13] The Restatement classifies agents as special and general only. Sec. 3.
[14] *Charleston Electrical Supply Co.* v. *Keyser Coal Co.*, 213 Ky. 389, 281 S. W. 185.

E. H. Whitson asserted that C. D. Owens had authorized the Hollywood Investment Company, as general agent, to sell his land in Hollywood. The court held that an agent empowered to sell land is a special agent. (Whitson v. Owens, 94 Fla. 1201, 115 S. 512)

General Agents. These agents are authorized by the principal to transact all of his affairs in connection with a particular kind of business or trade, or to transact all of his business at a certain place. To illustrate, a person who is appointed by the owner of a store to be general manager is a general agent. Thus it is stated that "to be a 'general' agent, or to be clothed with 'general authority,' as that word is used in law, means no more than to have general authority in reference to a particular business or employment." [15]

I. E. May and F. L. Lawler were authorized to execute bonds in behalf of the Capital City Surety Company. They were empowered to negotiate and write bonds, to accept and reject risks, to form the terms of the bonds, to use the corporate seal, and to receive premiums. They were deemed to be general agents. (Corklite Co. v. Rell Realty Corp., 249 N. Y. 1, 162 N. E. 565)

Universal Agents. These are agents who theoretically are authorized by their principals to do all acts which can be delegated lawfully to representatives. This form of agency rarely, if ever, exists. The appointment of a guardian to act for one incapable of self-care seems to be the relation which comes nearest to being this form of agency.

Purpose of Agency. In general, an agency relation may be formed for the purpose of doing any act which the principal himself may lawfully do. To this general rule, however, there are several exceptions which may be divided into two classes.

First, an agent cannot be employed to perform acts which are opposed to public policy. By way of illustration, the courts will not enforce an agency contract whereby one person is employed to procure a marriage, on the ground that such acts are contrary to the interests of society.[16] Acts which in themselves are immoral or illegal may be added to this class of ex-

[15] *Fishbaugh* v. *Spunaegle,* 118 Iowa 337, 98 N. W. 58.
[16] *Morrison* v. *Rogers,* 115 Calif. 252, 46 P. 1072.

ceptions, although generally they cannot be lawfully performed by the principal, and are therefore excluded by the general rule. In a refusal to enforce an agency contract on the ground of its being opposed to public policy, it is not necessary to show that an injury has occurred to the principal or others or that there has been any misconduct on the part of the agent. It is sufficient if the natural and probable tendency of an agency of this nature affords opportunity to do harm.

> Lillian T. Carr purchased certain bonds through her agent, G. H. Sherman, who, unknown to her, also was agent of the seller, the National Bank & Loan Co. She was allowed to avoid the contract, the court stating that "a fraudulent motive was not necessary to be proved," either on the part of the seller or on part of the common agent. (Carr v. National Bank & Loan Co., 167 N. Y. 375, 60 N. E. 649)

Second, an agent cannot be employed to perform acts or duties of a personal nature. There are certain duties involving trust and judgment, and acts requiring individual attention, which the courts will not permit to be delegated to another. To illustrate, one cannot authorize another to make his will or to list his taxable property under oath as required by statute.[17]

QUESTIONS

1. In an article outlining the history of business it is stated that "the doctrine of agency is of outstanding significance in the development of modern business." Do you agree with this statement?

2. The Tennessee Coal, Iron & Railroad Company shipped certain cars containing coal to its agent, Grote. Seals, an aged negro, was employed by Grote to unload the cars at $1.50 to $2.50 a car. Was Seals an agent?

3. Marvin hired Foster to mow his lawn. Foster, after starting the task, complained that the blades of the lawnmower with which he had been furnished by Marvin were dull. Marvin told Foster to purchase on credit for him the instruments that were necessary to sharpen the blades. Was Foster acting as an agent for Marvin?

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[17] *Comm.* v. *Farmers Shippers Warehouse Company*, 107 Ky. 1, 52 S. W. 799.

4. It has been said that agency, although not necessarily based on a contract, is a consensual relation. What was meant by this statement?

5. Shiras, a dealer in farm implements, is located in a small western city. His advertisement carries the following phrase, "Surego Tractor Agency." Does this mean that Shiras is an agent of the manufacturer of Surego Tractors?

6. Henrietta Popper and her daughter, Estelle Hasberg, were partners, doing business under the name of Popper & Hasberg. The firm by a written instrument authorized one Emanuel Popper to issue for them certain promissory notes payable at the Nineteenth Ward Bank of New York City. Could the partnership lawfully employ an agent to transact the firm's business?

7. "Certain groups of persons must necessarily act through representatives." Is this statement true? Illustrate.

8. Robert McGregor brought an action against Edward Mackinley, of Philadelphia, Pennsylvania. He contended among other things that McGregor's wife, Mary, had acted as McGregor's agent. The action was brought in the year 1838, at which time a married woman could not contract to make herself personally liable. Could Mary McGregor have been an agent as contended by Mackinley?

9. Radford and Brune are discussing questions concerning agency. The former maintains that there are some situations in which it is desirable to require agents to possess specific qualifications. Brune denies this. Do you agree with Radford or Brune?

10. Hatch employed Remington to sell a farm. Remington as agent for Pendleton bought the farm for the latter. Neither principal knew that Remington was the agent of the other. Hatch is being sued by Remington for the amount of commission. No evidence is offered to show that an injury, due to Remington's dual position, had occurred to either of the principals. Is Remington entitled to judgment?

11. It is required by law that every vessel must be registered under oath of the owner. Fowler, a shipowner, sends a representative to enroll his vessel. Will registration under the oath of the agent be effectual?

12. The Bermudez Asphalt Paving Company, a corporation of Illinois, having principal offices in Chicago, employed George W. Crichfield to obtain for it certain contracts with the city of Chicago by influencing city officers. Thereafter, Crichfield brought an action against the company to recover certain compensation claimed to have been earned under the agency agreement. Was he entitled to judgment?

13. "An agent may do any act for another which the latter may lawfully perform." Do you agree with this statement?

Part II—Creating the Agency

By Appointment. The usual method of forming an agency is by informal appointment. The agent is merely requested to act for and in behalf of the principal. In many cases, however, the appointment is expressly made. No particular form of language is necessary so long as the words used indicate that the principal wishes another to represent him. In most instances the authority of the agent may be conferred orally.[1] Thus, when one hails another who is driving to the city and requests him to purchase certain goods for him, there is ordinarily an authorization lawfully made.[2]

> The authority of an agent to execute a negotiable note, check, or draft is not required to be in writing under the Uniform Negotiable Instruments Law, which has been adopted without change in nearly all the states. (McLeod State Bank v. Vandemark, 51 N. D. 573, 200 N. W. 42)

Some appointments, however, must be made in a particular way. Many states by slightly different statutes require the appointment of an agent to be in writing when the agency is created to acquire or dispose of any interest in lands. By way of illustration, in some states an agent who is to make a contract to sell land for the principal must be authorized in writing.[3] The fourth section of the Statute of Frauds, as enacted in many states, requires an enforceable agreement creating the authority of the agent to be in writing when the relation is to exist for a period beyond one year from date of the contract or is to start later than one year thence.[4] In a few states the appointment must be in writing when the agent is authorized "to enter into a contract required by law to be in writing." [5] In one state, Kentucky, an agent cannot bind his principal as a surety unless his authority is in writing.

> South Dakota and Kentucky have changed the Uniform Negotiable Instruments Law, so as to require the authority

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[1] R., Sec. 26.
[2] *Wiger* v. *Carr*, 131 Wis. 584, 111 N. W. 657.
[3] *Malone* v. *McCullough*, 15 Colo. 460, 24 P. 1040.
[4] R., Sec. 468.
[5] *Hartt* v. *Jahn*, 59 Mont. 173, 196 P. 153.

to be in writing when an agent is to make the signature of any party to a negotiable note, check, or draft. (First Nat. Bank v. Montgomery, 47 S. D. 97, 196 N. W. 95; Selma Sav. Bank v. Webster County Bank, 182 Ky. 604, 206 S. W. 870).

At common law the appointment to execute an instrument under seal could be conferred only by a writing of equal for-

Know All Men by These Presents:

That I, Jonathon Westmont, of the City of Indianola, County of Warren, State of Iowa

have made, constituted and appointed, and by these presents do make, constitute and appoint Mr. Clarence L. Brown, of the City of Indianola, County of Warren, State of Iowa

true and lawful attorney, for me and in my name, place and stead, to act for me in connection with my business of general merchandising at Indianola.

1. To draw checks against my account in the Peoples Trust and Savings Bank.
2. To indorse notes, checks, drafts, or bills of exchange which may require my indorsement for deposit as cash or for collection in the said bank.
3. To accept all drafts or bills of exchange which may be drawn upon me.

giving and granting unto the said attorney full power and authority to do and perform all and every act and thing whatsoever, requisite and necessary to be done in and about the premises, as fully to all intents and purposes as I might or could do, if personally present, with full power of substitution and revocation; hereby ratifying and confirming all that the said attorney or his substitute shall lawfully do, or cause to be done, by virtue hereof.

In Witness Whereof, I have hereunto set my hand, this twentieth day of September in the year one thousand nine hundred and

Signed and acknowledged in presence of us:

Albert Tieman
E. E. Evers
Robert A. Scott

Jonathon Westmont

POWER OF ATTORNEY

A formal, written document appointing an agent is known as a power of attorney.

mality.[6] By way of illustration, when the agency was created to execute a bond or a deed, the authority was required to be in writing under seal.[7] The early common-law doctrine requiring appointments of agents by corporations to be under seal has been abandoned by most courts.

By Estoppel. The appointment of an agent may be implied from acts or conduct. If a person, knowingly and without dissent, permits another to act as his agent, the authority will be implied, and that person will be liable as principal.[8] Thus, if the owner of a hotel allows another to occupy the position and assume the duties of clerk, the authority may be inferred from the conduct of the owner.[9] In this case the person acquiesces in the acts done under assumed authority, thus misleading third parties. In such instances courts apply the doctrine of estoppel, which precludes one the right to deny the existence of authority which his conduct has led others to act upon, when such denial would injure the parties who reasonably rely upon such authority.

> A corporation allowed its bookkeeper to assume the duties of its treasurer. It was held that the corporation would not be permitted to deny the agency, as to persons who in good faith had been misled by the appearance of authority which the corporation allowed the bookkeeper to have. (Columbia Mill Co. v. National Bank of Commerce, 52 Minn. 224, 53 N. W. 1061)

This is equally true when by affirmative conduct one reasonably leads a third party to believe that another has authority to act as his agent. In the case previously cited, if the hotel owner voluntarily places one in the position of clerk, he will be bound by that person's acts in that capacity. Thus it is stated that "if a person holds out another as his agent, by placing him in control of his business or property, and a third person acts upon the faith of such appearances, the principal may be bound by the acts of the agent if within the scope of

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[6] R., Sec. 28.
[7] *Dutton* v. *Warschauer*, 21 Calif. 609, 82 Am. Dec. 765.
[8] R., Sec. 27.
[9] *Curtis* v. *Murphy*, 63 Wis. 4, 22 N. W. 825.

such ostensible authority, although, as between the agent and employer, no such authority in fact existed." [10]

Markley dealt with William Clement who was working in a telegraph office. If the company placed Clement in charge of the office, it was unnecessary to the establishment of agency to prove that Clement was actually authorized to act as agent of the company. (Markley v. Western Union Telegraph Co., 144 Iowa 105, 122 N. W. 136)

There may also be situations in which a person cannot deny that another is his agent because his course of business justifies an estoppel. In some cases where one has previously employed another to act as his agent, a third person is reasonably entitled to believe that such person is his agent. This is true, however, only when he has acted in similar transactions. In other words, the fact that one has been employed to do acts of one nature does not imply an agency to do acts of an entirely different kind. It is also generally held that isolated acts of agency or even occasional acts are insufficient to create an agency by estoppel.

By Ratification. When one person, purporting to act as agent for another, does an act, the latter may repudiate the transaction or approve it. If the act is approved, it is said to be ratified. *Ratification* is the voluntary acceptance of an unauthorized act made in one's behalf.[11] "It is the election by a person, and the expression of such election by words or conduct, to accept an act or contract previously done or entered into in his behalf by another who had at the time no authority to do the act or make the contract on his behalf. If certain acts have been performed or contracts made on behalf of another without his authority, he has, when he obtains knowledge thereof, an election either to accept or repudiate such acts or contracts. If he accepts them, his acceptance is a ratification of the previously unauthorized acts or contracts and makes them as binding upon him from the time they were performed as if they had been authorized in the first place." [12]

The finance committee of a county board, without authority, employed a professional man to render services for

[10] *Barnett* v. *Glutting*, 3 Ind. A. 415, 29 N. E. 154.
[11] R., Sec. 82.
[12] *Gallup* v. *Liberty County*, 57 Tex. Civ. A. 175, 122 S. W. 291.

the board. Thereafter, the board ratified the act of the committee and became bound to pay for the services from the time of employment by the committee. (Smathers v. Board of Chosen Freeholders, 113 N. J. L. 281, 174 A. 336)

When it is necessary to have authority in writing under seal to do an act, ratification must be made in the same manner. In most instances, however, it may be impliedly as well as expressly made.[13] Ratification is implied by any conduct which reasonably leads another to believe that the unauthorized act is approved. Approval is commonly inferred from conduct when the principal brings an action to enforce the act, when he accepts the benefit of the act,[14] or when, with knowledge of the act, he fails to repudiate it.[15] Thus, when one without authority makes a contract for another who, after learning all the facts, fails to repudiate the transaction, his failure to act within a reasonable time may be interpreted as an intention to affirm it.[16]

The owner of a cotton compress received money under a contract made by Darrell Moore, as his agent. Although contending that Moore had no authority to make the contract, he refused to return the money. It was held that the owner ratified the act of Moore. (Joy v. Moran, 172 Okla. 585, 47 P. [2d] 95)

The essential elements of a valid ratification are:

(1) In most states the one assuming the authority of an agent must act for the party seeking to affirm the act.[17] For example, if a lawyer adjusts a claim as the agent of the mother of an injured boy, the doctor who treated the boy cannot ratify the transaction.[18]

(2) The alleged principal must at the time of the acts be identified, or be capable of being ascertained, as, for instance, in cases where he is described as the guardian or the administrator.[19]

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[13] R., Sec. 93.
[14] R., Secs. 98 and 99.
[15] R., Sec. 94.
[16] *Lemche* v. *Funk*, 78 Wash. 460, 139 P. 234.
[17] R., Sec. 85.
[18] *Watkins* v. *Clemmer*, 129 Calif. A. 567, 19 P. (2d) 303.
[19] R., Sec. 87.

(3) One who attempts to ratify must have been capable of authorizing the act at the time it was done.[20] By way of illustration, a corporation formed subsequently to contracts made by the promoter cannot ratify such acts.[21] In such cases, the corporation adopts the promoter's agreements.

(4) One who attempts to ratify must be capable of authorizing the act at the time of giving approval.[22] To illustrate, when one without authority sells the house of another, the latter, if he later sells the house himself, cannot afterwards ratify the act of the alleged agent so as to cut off the rights of the subsequent purchaser.[23]

(5) The alleged principal must approve the entire act or repudiate it.[24] He cannot reject the burdens attached to the transaction and accept only the benefits.

(6) Illegal acts generally cannot be ratified.[25] Courts take different views in respect to the ratification of a forgery. Some hold that a forgery can be ratified. Other courts take a contrary view on the ground that the forgery is a void act, that the one committing it did not act as an agent, or that ratification would tend to suppress prosecution. Even though the forgery can be ratified, the forger is liable in a criminal action by the state.

By Law or Necessity. It is frequently asserted that in a few instances the authority to act as agent is created by operation of law or is based upon necessity. Some of these situations are:

(1) A wife has power to pledge the credit of her husband for necessaries that he does not supply.

(2) Minor children have power to purchase necessaries upon the credit of a father who does not supply them.

(3) An unpaid vendor has power to sell goods of the purchaser that are in his possession.

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[20] R., Sec. 84.
[21] *Battelle* v. *Northwestern Cement Co.*, 37 Minn. 89, 33 N. W. 327.
[22] R., Sec. 84.
[23] *Graham* v. *Williams*, 114 Ga. 716, 40 S. E. 790.
[24] R., Sec. 96.
[25] R., Sec. 86.

(4) The shipmaster has power to bind the owner on contracts for supplies and repairs.

It has been stated that the authority in these cases is that of agency and that the cases are exceptions to the rule that the relation is consensual and established only by the voluntary conduct of the principal. It is doubtful whether this is true.[26] "The first two are probably better disposed of as cases of *quasi*-contract. The third has been held not to be a case of agency. The fourth is doubtless a case of agency implied in fact." [27]

Proving the Relation. As a general rule the burden of proving the existence of an agency rests upon the party alleging and depending upon it. Thus, when the plaintiff alleges the existence of the relation of agency upon which his claim is founded, he is required to prove it.[28] Although ordinarily the burden of proving the agency is upon the plaintiff, it may be upon the defendant. For example, in an action for a debt, if the defendant alleges that payment has been made to the plaintiff's agent, the defendant must prove that the person whom he paid was the agent of the plaintiff. It should be kept in mind that the burden of proving the agency may rest upon the principal, the agent, or the third party, according to the circumstances of each case.

> J. Zitserman owed a debt to H. Goodman, who assigned his rights to the Guaranty Company of Maryland. After notice of the assignment, Zitserman paid the obligation to Goodman. When sued, he asserted that Goodman was agent of the company to receive payment. Zitserman had the burden of proving the agency. (47 R. I. 466, 134 A. 4)

The existence of an agency cannot be proved by statements or admissions made by an alleged agent or by the fact that he purported to act as an agent.[29] He cannot create his own authority. Thus, in a trial in which agency is in dispute, the third party cannot introduce the statement of the alleged

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[26] R., Sec. 20.
[27] *Mechem, Outlines of Agency*, 3rd ed., p. 10, §16.
[28] *Kelly* v. *Strong*, 68 Wis. 152, 31 N. W. 721.
[29] R., Sec. 285.

agent as evidence that he was an agent.[30] In all cases the agency must be proved by words or acts of the principal. The agent may be called as a witness, and his testimony as to facts may be considered by the jury in determining whether an agency existed.[31] This must be distinguished, however, from his conclusions made previously by statements and admissions.

QUESTIONS

1. B. E. Norvell represented himself to be the agent of J. W. Rugeley and others for the purpose of selling a large ranch in Matagorda County, Texas. J. M. Barnes came to the ranch and entered into an agreement with Norvell to purchase the land. Rugeley and the other owners knew of the transaction and indicated no objection to it. When sued by Barnes for breach of contract, the owners contended that they were not bound by the agreement because Norvell had no authority to act as their agent. Do you agree?

2. Holt and Daniels are discussing the appointment of an agent for their firm. A question arises as to making the appointment in writing. The former contends that the law does not require the appointment of any agent to be in writing. The latter maintains that all appointments of agency are required to be in writing. Do you agree with Holt or Daniels?

3. Taylor, in behalf of the National Surety Company, entered into a contract with William M. Anderson and another. Taylor allegedly had no authority to make the agreement. After learning of the transaction, the surety company partly performed the terms thereof. Later the company repudiated the agreement on the ground that Taylor had no authority to bind the company by such an agreement. Could the company rightfully do this?

4. Stockton is suing Crider on a contract. It is alleged that the agreement was executed by Cunning. A statement of Cunning that he was an agent of Crider is introduced to prove the agency. Is the statement admissible?

5. Kosgrove has often employed Hyman to purchase used automobiles for him. Cuthman, who knows this fact, pays a debt due Kosgrove to Hyman. When sued by Kosgrove, Cuthman claims that he paid the former's agent. Is this a valid defense?

6. Plumb, without authority, purchases an oriental rug for Fink, thinking the latter would like to possess it. Some months later, Fink

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[30] *Holbeck* v. *Illinois Bankers Life Assur. Co.*, 318 Ill. A. 296, 47 N. E. 721.
[31] R., Sec. 284.

learns of the transaction. What are his rights and liabilities in respect to the rug, if any?

7. Robey, who sold a set of books to MacMillan, is now suing for the purchase price. MacMillan claims that he paid the amount to Deitman, the agent of Robey. Who must prove the agency?

8. Conway on July 6 ratifies an unauthorized oral agreement made by Steiner as his agent. The contract was made by Steiner on January 6 and called for a delivery of a quantity of stone on January 14 of the following year. Conway sues for breach of contract, and the defense is that the agreement is not in writing as required by law in case of agreements not to be performed within the period of one year. Is Conway entitled to recover?

9. Vattier, without authority, enters into an agreement as agent of the guardian of Chouteau to purchase a boy's overcoat from Hinde. Candler, who is guardian of Choutau, is informed of the transaction. Appreciating the fact that Vattier secured the promise to sell the coat at a bargain price, he wishes to ratify Vattier's act. May he do so?

10. Leiter agreed to purchase a ton of coal at a given price from Kilpatrick. The former told Bonar that he was unable to perform his promise. Bonar informed Kilpatrick that he ratified the act of Leiter. Bonar now seeks to enforce the agreement. What are his rights?

11. Mellus executed a promissory note for $500 payable to Lothrop, forging Rickett's name as maker. Rickett wishes to ratify Mellus' act. May he do so?

12. Thistlewaite, without authority, sells fish as the agent of Painter and warrants the delivery of fresh fish. Painter, after learning of the transaction, wishes to ratify the sale but not the warranty. May he do so?

13. "There are a few situations in which the relation of agency is established without the assent of the principal." What is meant by this statement? Do you agree?

Part III—Extent of Authority

Duty to Ascertain. A person dealing with an agent is required, first, to ascertain whether the agent is in fact what he claims, and second, to learn the extent of his powers. This second duty is particularly important in the case of a special agency. The third party cannot rely upon the assertion of the agent as to the extent of his authority. He must seek evidence emanating from the principal.

> H. H. Green alleged that K. B. McMicken was agent of P. W. Litchfield. He was not allowed to prove the agency by showing that McMicken had claimed to be agent of Litchfield. The court declared: "The agent certainly cannot confer authority upon himself, or make himself agent by merely acting as such, or saying that he is one." (Litchfield v. Green, 43 Ariz. 509, 33 P. [2d] 290)

If the authority of an agent is contingent upon the happening of some event, one may not ordinarily rely upon the statement of the agent as to the fulfillment of the condition. Thus, when an agent is authorized to sell for his principal a given quantity of oranges only in the event of the arrival of a specified ship, one dealing with the agent should ascertain for himself whether the ship has arrived and should not rely upon the statement of the agent in respect to the fact. Some courts make an exception to the rule that one may not rely upon the statement of the agent as to the happening of the contingency. This exception is made in cases in which the happening of the event is peculiarly within the knowledge of the agent and cannot easily, if at all, be ascertained by the party dealing with the agent. As an illustration, if the agent of a common carrier issues a bill of lading for goods without receiving the goods, the principal is held liable to one who accepts the bill in good faith.[1] This view, adopted by the Uniform Bills of Lading Act, is justified because, although the authority of the agent to issue bills of lading is contingent upon receiving the goods, persons taking bills of lading have no way of ascertaining whether the agent did in fact receive the goods.

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[1] *Sioux City & Pacific R. R. Co.* v. *First Nat'l Bank*, 10 Nebr. 556, 7 N. W. 311

The Uniform Bills of Lading Act has been adopted by: Alabama, Alaska, Arizona, Arkansas, California, Connecticut, Delaware, Idaho, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nevada, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Vermont, Washington, and Wisconsin. (4 Uniform Laws Annotated, Cumulative Annual Pocket Part, for use during 1946)

The third party who deals with an agent is also required to take notice of any acts which are clearly adverse to the interest of the principal.[2] Thus, if the agent obviously intends to use the funds of the principal for his own benefit, the person dealing with the agent acts at his own peril.[3]

Extent of Powers. As to third parties, the powers of an agent may be much greater than the authority granted to him by the principal. The extent of the powers of an agent is measured in terms of several elements, of which the authority actually intended by the principal may be the least important.

Declared Authority. The power of an agent is, of course, coextensive with the authority voluntarily declared by the principal. When such authority is required to be in writing or under seal, the agent's powers are restricted by any limitations contained in the instrument. This is also true when the third party knows that the agent is acting under express authority. By way of illustration, when the agent indicates that he is acting by power of attorney, the third party must take notice of the limitations in the instrument.[4]

The secretary-treasurer of a corporation had a power of attorney, authorizing him to receive money, to make collections, and to give acquittances. It was held that "letters of attorney are to be strictly construed," and that the agent had no power to postpone the lien of a recorded mortgage. (Culbertson v. Cook, 308 Pa. 557, 162 A. 803)

Incidental Authority. An agent has implied authority to perform any act reasonably necessary to execute the declared

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[2] R., Sec. 9.
[3] *Bank* v. *Ohio Furniture Co.*, 57 W. Va. 625, 50 S. E. 880.
[4] *Mt. Morris Bank* v. *Gorham*, 169 Mass. 519, 48 N. E. 341.

authority.[5] To illustrate, if the principal authorizes the agent to purchase goods without furnishing funds to pay for them, the agent has implied power to purchase the goods on credit.[6]

> J. H. Uerling was authorized by E. A. Shriver to collect a mortgage debt. Incidental to the power to collect the money, he possessed the implied authority to surrender the mortgage and note, since such acts were necessary to carry out the main authority. (Shriver v. Sims, 127 Nebr. 374, 255 N. W. 60)

Customary Authority. An agent has the implied authority to do any act which, according to the custom of the community, usually accompanies the transaction for which he is authorized.[7] A salesman, for example, without authority warrants the condition of an allotment of fish upon arrival. If such warranty is usual and customary in the trade where the sale is made, the principal is bound.[8]

> L. M. Romer, a salesman, was authorized to receive payments for cars sold. He accepted a check of a purchaser instead of cash. It was held that the agent had implied authority to accept payment in the usual or customary way. (California Sterns Co. v. Treadwell, 82 Calif. A. 553, 256 P. 242)

Apparent Authority. An agent has by estoppel any authority which the principal by his words or conduct reasonably leads a third party to believe that he possesses.[9] Thus, "where a principal has, by his voluntary act, placed an agent in such situation that a person of ordinary prudence, conversant with business usages and the nature of the particular business, is justified in presuming that such agent has authority to perform a particular act, and therefore deals with the agent, the principal is estopped, as against such third persons, from denying the agent's authority." [10]

Limitations on Authority. It has been indicated that third parties are bound by the limitations on the authority of the agent contained in instruments when written authority is

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[5] R., Sec. 35.
[6] *Swindell* v. *Latham*, 145 N. C. 144, 58 S. E. 1010.
[7] R., Sec. 36.
[8] *Pickert* v. *Marston*, 68 Wis. 465, 32 N. W. 550.
[9] R., Sec. 27.
[10] *Bush Grocery Co.* v. *Conely*, 61 Fla. 131, 55 S. 867.

required or is known to exist. They must also adhere to other limitations which become known to them.[11] The purpose of the rule that a principal is bound by apparent authority is to protect innocent parties, and "it has no application when the person dealing with the agent has actual knowledge of the agent's powers." [12]

Frequently, however, the principal will give secret instructions to his agent in respect to the performance of his task. Such instructions, although limiting the agent's authority as between him and the principal, have no effect upon the rights of a third party.[13] One is not required to guard against what is known as private instructions. Thus it has been stated that "if the instructions are of such a nature that they would not be communicated if an inquiry were made (even though it be the duty of the person to make the inquiry), it is not necessary that it be made, for they would not be communicated, if made." [14]

Delegation of Authority. An agent cannot, as a general rule, delegate his authority to another.[15] In other words, unless the principal impliedly or expressly consents, an agent cannot appoint subagents to carry out his duties. This is because an agent is usually selected in reliance upon some personal qualifications, and it would be unfair, at least, if not injurious to the principal, if the authority to act could be shifted to another. Thus, if the agent is appointed for the performance of any task requiring discretion or judgment, the authority cannot be transferred to another.[16]

An agent of the New Jersey Fidelity & Plate Glass Co. was authorized to adjust claims. It was contended that the agent had delegated his authority to one Shea. It was held that the authority of the agent was given because of special skill and fitness, hence could not be delegated to another. (Clark v. Shea, 130 Oreg. 195, 279 P. 539)

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[11] R., Sec. 166.
[12] *Francis* v. *Spokane Amateur Ath. Club*, 54 Wash. 188, 102 P. 1032.
[13] R., Sec. 160.
[14] *Towle* v. *Leavitt*, 23 N. H. 360, 55 Am. Dec. 195.
[15] R., Sec. 18.
[16] *Central, etc., Ry. Co.* v. *Price*, 106 Ga. 176, 32 S. E. 77.

There are a few instances, however, when the agent is permitted to delegate his authority.[17] He may appoint subagents under the following circumstances:

(1) When the acts to be done involve only mechanical or ministerial duties. Thus, an agent to make application for hail insurance on wheat may delegate to another the clerical act of writing and signing the application.[18]

(2) Where a well-known and usual custom justifies such appointment. To illustrate, if one is authorized to buy or sell a grain elevator, he may do so through a broker when that is the customary method.[19]

(3) When such appointment is justified by necessity or sudden emergency. For instance, an agent to collect tolls, who is in charge of a bridge, may appoint another to collect tolls in his place when he is required to be on the bridge making repairs.[20]

(4) When it is contemplated by the parties that subagents would be employed. For example, a bank in some states may use subagents to receive payments of notes which have been left for collection.[21]

QUESTIONS

1. Booker, claiming to be an agent of Newhall, was negotiating the sale of Newhall's meat machine to Kastens. The latter telephoned Newhall to learn whether Booker was in fact his agent. Having been told that Booker was an agent of Newhall, may Kastens safely enter into an agreement to purchase the machine?

2. Beckwith is authorized to act for Norstrum in a deal on Friday provided the steamship, "G. W.," on which the latter is a passenger, does not arrive on the preceding Thursday. Beckwith falsely tells Comstock that the ship did not arrive, and they execute an agreement. What are Comstock's rights against Nostrum on the agreement?

3. McClure is authorized to collect debts due Grosh. After McClure informs him that he plans to abscond with his collections, Hurst pays to McClure an account due Grosh. Grosh is suing Hurst for the amount of the debt. Is he entitled to judgment?

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[17] R., Sec. 17.
[18] *Wright* v. *Providence Washington Ins. Co.*, 130 Kans. 438, 286 P. 237.
[19] *Fritz* v. *Chicago Grain & Elevator Co.*, 136 Iowa 699, 114 N. W. 193.
[20] *Ada-Konawa Bridge Co.* v. *Cargo*, 163 Okla. 122, 21 P. (2d) 1.
[21] *Bailee* v. *Augusta Sav. Bank*, 95 Ga. 277, 21 S. E. 717.

4. Howls is placed by his principal in a position of apparent general agent, but he is really acting under limited powers, as set forth in writing. Clausen knows of these limitations, but he enters into an agreement with Howls as though the latter had the powers of a general agent. Is the principal liable on contracts which Howls makes with Clausen beyond his actual authority?

5. An agent who was authorized to execute agreements with merchants for the shipment of goods entered into an agreement of this nature with Conrad. The agent and Conrad also agreed upon the time when the means of transportation would be furnished. Upon the agent's failure to furnish transportation at the agreed time, Conrad sued the principal, who claimed that the agent did not have authority to make the agreement. Was the principal liable?

6. Harding is appointed purchasing agent for a company and is instructed not to make parol contracts. Van Loon, having no knowledge of these instructions, enters into an oral agreement with Harding. Is the agreement enforceable against the principal?

7. Levy, agent of Paige to sell a table, is instructed to sell it at $25, if possible, but in any event for no less than $20. Levy agrees to sell the table to Warren for $22 in spite of the fact that Westbrook was willing to pay $25 for it. Paige refuses to deliver the table to Warren. The latter brings an action for damages against Paige. Is he entitled to judgment?

8. Hurdle, who is authorized to sell Kable's piano, makes a sale on credit to Ordway. Kable refuses to deliver the piano on the ground that Hurdle did not have authority to sell on credit. Ordway brings action for breach of contract against Kable and offers evidence to prove that sales on credit are in accordance with well-known recognized usages of the trade. Should this evidence be admitted?

9. Perez, with the knowledge of Goddard, represents himself as the latter's purchasing agent. He has been told, however, to make no purchases. Perez enters into an agreement to sell a quantity of Goddard's products to Emmons. Upon failure to deliver, Emmons sues Goddard. Is he entitled to recover damages?

10. Perry, who owned one hundred shares of a certain stock, wired a friend in New York City to sell the stock for him at the market price. His friend immediately sold the stock through a broker. Perry contended that his friend was at fault in that he did not personally sell the stock. Was that true?

11. Lube is authorized by Vesey to purchase twenty-five head of cattle from Bush, who lives on a ranch approximately five miles from the nearest village at which trains stop. After arriving at the village, Lube hires an automobile to go to visit the ranch for the purpose of making the purchase. Vesey refuses to pay the owner of the car for its use. Is he liable for this amount?

Part IV—Duties and Liabilities of the Parties

Agent to the Principal. There are many duties imposed by law upon the agent which he owes to the principal as incidents to the relation. In the main, these duties are in respect to loyalty, obedience, care and skill, accounting, information, and performance.

Loyalty. The law requires an agent to be faithful to the interests of his principal.[1] Therefore, except when there is no conflict in interests, he cannot represent another party in a transaction which he is conducting for the principal. For example, an agent may not represent both the buyer and the seller of corporate stock.[2] His efforts and time cannot be employed to assist competitors. He cannot deal with himself while representing the principal, or profit by confidential information gained while acting as an agent. To illustrate, if a clerk learns that his employer is negotiating for a renewal of a lease and secretly obtains the lease for himself, the court will compel the surrender of the lease to the principal.[3]

> An agent of H. M. Doner, to redeem certain mortgaged real estate, obtained with his own money title to the property for his own purposes. It was held that the property was held in trust for the principal. (Doner v. Phoenix Joint Stock Land Bank of Kansas City, 381 Ill. 106, 45 N. E. [2d] 20)

Obedience. The agent must obey all lawful instructions of his principal.[4] For example, when an agent is instructed to collect cash only, and upon delivery of goods he accepts a forged certified check, he is liable to the principal.[5] The fact that he acted in good faith, intending to benefit the principal, does not affect his liability. When the instructions are not clear, the agent may follow a reasonable interpretation of them without liability, although the result may be contrary to the intent of the principal.

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[1] R., Sec. 387.
[2] *Rice* v. *Davis*, 136 Pa. 439, 20 A. 513.
[3] *Gower* v. *Andrew*, 59 Calif. 119, 43 Am. Rep. 242.
[4] R., Sec. 385.
[5] *Mogul* v. *Lavine*, 247 N. Y. 20, 159 N. E. 708.

The Union Savings & Loan Ass'n gave ambiguous instructions to its agent, an abstract company, with respect to payment of taxes required in connection with a loan to a third party. The company, having acted under a reasonable but erroneous interpretation of the orders, was under no liability to the principal. (Smith v. Union Savings & Loan Assn., 97 Colo. 440, 50 P. [2d] 538)

Care and Skill. It is the duty of an agent to exercise reasonable care, skill, or diligence in the performance of his task.[6] This is measured by the conduct of the ordinarily prudent man in doing a similar service. In some cases, however, a higher degree of skill may be required. To illustrate, certain agents, such as brokers or attorneys, must exercise the skill ordinarily possessed by persons engaged in that particular work.[7]

A banker made a loan for his principal, taking as collateral forged certificates of stock. It was held that the care and skill required of him was "such as should characterize a banker operating for others in a financial center, and different in kind from the ordinary diligence and capacity of the ordinary citizen." (Isham v. Post, 141 N. Y. 100, 35 N. E. 1084)

Accounting. An agent must account to his principal for all property or money belonging to his principal which comes into the agent's possession.[8] He should keep such property or money separate and distinct from his own. If an agent intermingles his property with the property of his principal so that it cannot be identified or separated, the principal may claim all of the commingled mass. When funds of the principal and of the agent are mixed, any loss must be suffered by the latter. For example, when the agent deposits the funds of the principal in a bank in his own name, he is liable for the amount if the bank should fail.[9] The agent should, within a reasonable time, give notice of collections made and render an accurate account of all receipts and expenditures.

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[6] R., Sec. 379.
[7] *Howard* v. *Grover*, 28 Me. 97, 48 Am. Dec. 478.
[8] R., Sec. 382.
[9] *Naltner* v. *Dolan*, 108 Ind. 500, 8 N. E. 289.

An agent was authorized to make collections for John Taylor, Sr. He was under a duty to make an accounting for all money received by him for his principal, and he became liable for interest on such money as was not accounted for from the time he should have turned it over to his principal. (Taylor v. Taylor's Ex'rs, 211 Ky. 309, 277 S. W. 278)

Information. It is the duty of the agent to keep the principal informed of all facts pertinent to the agency which may enable the principal to protect his interests.[10] To illustrate, an agreement to pay for information which the promisee had secured while employed as an agent in connection with the matter is unenforceable on the ground that the principal was entitled to the information.[11]

While W. D. Turner was agent of R. L. Emerson to look after certain land, timber was cut and removed from the land by a wrongdoer. Failure to notify Emerson of such cutting and removing of timber, if known to the agent, would render Turner liable for damages resulting therefrom. (Emerson v. Turner, 95 Ark. 597, 130 S. W. 538)

Performance. The agent must live up to the terms of his contract.[12] He must not exceed his authority as defined by the agreement. He is liable for any loss caused the principal by the performance of an unauthorized act binding the latter. For example, when an agent, acting under an unrevoked power of attorney, wrongfully releases a mortgagor, and this unauthorized act binds the principal, he is liable to the principal.[13] The agent is also under duty to complete the term of employment.

An agent of J. H. Sentell failed to invest money in the reorganization of Pointe Coupe Trust & Savings Bank and to obtain stock for it in accordance with the agency agreement. For such failure to act the agent was liable to the principal. (Sentell v. Roberts, 17 La. A. 628, 135 S. 268)

Good Conduct. The agent must conduct himself with such propriety that he will not bring disrepute upon his principal or upon the business in which he is engaged. He must also

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[10] R., Sec. 381.
[11] *Dorr* v. *Camden*, 55 W. Va. 226, 46 S. E. 1014.
[12] R., Sec. 383.
[13] *Persons* v. *Smith*, 12 N. Dak. 403, 97 N. W. 551.

conduct himself in respect to the principal so that continued friendly relations are possible.[14]

Principal to the Agent. The relation of agency imposes certain obligations upon the principal in respect to his agent. These obligations may be divided into four classes: compensation, reimbursement, indemnity, and performance.

Compensation. An agent may serve gratuitously, although he is usually entitled to compensation. Whether he is entitled to remuneration from the principal depends upon their agreement, which may be express or implied. Compensation is implied when one requests another to perform services under circumstances which reasonably justify the expectation of being paid.[15] For example, when one requests an agent, as a broker or an attorney, to act in his professional capacity, it is implied that remuneration is to be given.[16] A promise to pay is not implied under circumstances in which the demand is made by a member of the same family or by a near relative. The amount of compensation, in the absence of an agreement, is determined by usage or customary rates, or by what the services are reasonably worth at that time and place. The agent is not entitled to compensation when the services performed are unlawful.

> The Oregon Hassam Paving Co. employed G. M. Hyland to obtain contracts with the city of Portland. The contract for this purpose in the manner indicated by the agreement was deemed illegal on the grounds of public policy. Hyland could not recover the agreed compensation for his services. (Hyland v. Oregon Hassam Paving Co., 74 Oreg. 1, 144 P. 1160)

Reimbursement. The principal is under a duty to reimburse the agent for all disbursements made at the request of the principal and for all expenses necessarily incurred in the lawful discharge of the agency for the benefit of the principal.[17] The agent cannot recover, however, for expenses caused

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[14] R., Sec. 380.
[15] R., Sec. 441.
[16] *Harrell* v. *Zimpleman*, 66 Tex. 292, 17 S. W. 478.
[17] R., Sec. 439(a) and (b).

by his own misconduct or negligence. By way of illustration, if the agent transfers title to the wrong person, he cannot recover from the principal the amount of expense incurred in correcting the blunder.[18]

> Bertha S. Messick directed the National Trust Company to purchase certains bonds for her. The agent, after making the purchase for the principal with its own money, was entitled to reimbursement for such expenditures. (Messick v. Rardin, 6 F. Supp. 200)

Indemnity. It is the duty of the principal to indemnify the agent for any losses or damages suffered without his fault on account of the agency.[19] For example, when an agent was compelled by law to pay over his own money, because under the direction of his principal he without knowledge had sold certain goods of a third party, he was entitled to recover the sum from the principal.[20] When the loss sustained is not the result of the execution of the agent's authority, but rather of the agent's misconduct or of an obviously illegal act, the principal is not responsible.

> William Lyon was compelled to pay the sum of $3,300, because at the instigation and for the benefit of his principal, the Drummond State Bank, he had pledged his credit to secure a certain obligation. He was entitled to indemnity from his principal. (Lyon v. Featherman, 80 Mont. 504, 261 P. 268)

Performance. The principal has one duty similar to one of the agent's in that he is required to live up to the terms of the contract of employment.[21] In the event of wrongful discharge by the principal, the agent may:

(1) Treat the contract as nonexisting and immediately bring action to recover the reasonable value of his services to date minus any sum previously paid.

(2) Treat the contract as existing and, in most states, immediately sue to recover the probable future damages. In some states this right is denied on the grounds that such damages are too speculative.

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[18] *Bailey* v. *Burgess*, 48 N. J. Eq. 411, 22 A. 733.
[19] R., Sec. 439(c) and (d).
[20] *Hoggan* v. *Cahoon*, 26 Utah 444, 73 P. 512.
[21] R., Secs. 432 and 450.

(3) Treat the contract as existing and, after the period of employment designated has expired, bring an action to recover actual damages. While waiting for this period to expire, the agent must attempt to mitigate his damages by securing similar employment. Thus, if an agent fails to use proper diligence in obtaining other employment, the amount he could have earned will be deducted from his damages.[22] Some states require that he accept any position for which he is fitted, but, as a general rule, it is only necessary to accept work of the same nature.

Agent to Third Parties. When an agent enters into a contract for his principal within the scope of his authority, he usually incurs no liability.[23] There are, however, several ways in which an agent may become personally liable.

Acting Without Authority. One who assumes to act as an agent without authority becomes personally liable to the parties with whom he deals.[24] Good faith on the part of the agent is no protection, for the law implies a warranty on his part. Thus, when one honestly but mistakenly believes that he has authority to act as an agent, he is liable to the third party.[25]

> J. W. Christensen sought to hold N. S. Nielson on a contract which, allegedly, Nielson, assuming to act as agent of the Hauser Packing Company, but without authority, had made with Christensen. The court declared that, in accordance with most decisions, a purported agent is not liable on the unauthorized contract, but upon an implied warranty or in tort for misrepresentation. (Christensen v. Nielson, 73 Utah 603, 276 P. 645)

Undisclosed Principal. An agent who fails to disclose the existence of his agency or the identity of his principal becomes liable to the same extent as though he were acting for himself.[26] If the third party actually knows of the agency, the agent is not liable; but the knowledge of the existence of an agency is not implied from the fact that the person is one who usually acts as an agent. For example, if a broker

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[22] *Elbert* v. *Los Angeles Gas Co.*, 97 Calif. 244, 32 P. 9.
[23] R., Sec. 320.
[24] R., Sec. 329.
[25] *Russell* v. *Koonce*, 104 N. C. 237, 10 S. E. 256.
[26] R., Sec. 322.

fails to disclose his agency, he is liable notwithstanding the fact that he usually acts as an agent.[27]

No Principal. One who assumes to act for a nonexisting principal or for a party not legally responsible binds himself, unless otherwise indicated by the party with whom he deals.[28] By way of illustration, when a promoter makes a contract for a corporation not then existing, he is usually personally liable.[29]

> F. A. Marsh signed an insurance contract as agent of Lloyds. The members of Lloyds underwrite insurance, if they so desire, after a proposed risk is posted. At the time of the foregoing contract, therefore, there were no principals. Hence, Marsh was liable on the contract, unless the party with whom he dealt agreed otherwise. (Ell Dee Clothing Co. v. Marsh, 247 N. Y. 392, 160 N. E. 651)

Wrongful Receipt of Money. An agent who receives money from third parties, which is acquired by illegal methods or is paid to him by mistake, is liable for it.[30] In the latter case, however, the agent is not liable when he has properly acted in respect to the money paid to him, and to compel repayment would be unjust to him. For example, when one person pays a sum of money to another under the erroneous impression that he owes the amount to the latter's principal, and the agent turns the money over to his principal before he receives notice of the error, the money cannot be recovered from the agent. Under these circumstances, the agent has acted fairly and in accordance with his instructions.[31]

> A bank, as agent, received illegal payment from the cashier of a bank on which a check was drawn, in violation of the National Bank Act. The receiver of the paying bank was allowed to recover from the agent who had participated in the wrongful payment. (Vann v. Federal Reserve Bank of Richmond, 47 F. [2d] 786)

Torts. An agent is liable for all torts or wrongful acts committed outside or within the scope of his employment. His

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[27] *Meyer* v. *Redmond*, 205 N. Y. 478, 98 N. E. 906.
[28] R., Sec. 326.
[29] *Lagrone* v. *Timmerman*, 46 S. C. 372, 24 S. E. 290.
[30] R., Sec. 339.
[31] *Cabot* v. *Shaw*, 148 Mass. 459, 20 N. E. 99.

responsibility for fraudulent, malicious, and negligent acts is not affected by the fact that he is acting as an agent.[32] When the act would be a tort if the agent were acting for himself, the fact that he is acting in good faith under the direction of his principal does not relieve the agent of liability. Thus, where one as the agent of another sells certain logs which belong to a third person, the agent is liable to the owner for the conversion of his property.[33]

> The Ogden & Clarkson Corporation was agent in sole charge of certain property, which the corporation was under a duty to keep in repair. As the result of its negligent failure to keep the building in repair, part of a chimney fell to the street, injuring A. Molino. The agent was liable for damages. (Molino v. Ogden & Clarkson Corporation, 243 N. Y. 450, 154 N. E. 307)

Pledging Own Credit. An agent may make himself personally liable on a contract in behalf of his principal by intentionally or unintentionally pledging his own credit. In the first instance the agent by express agreement assumes liability for the contract. In the latter case the agent may believe that he binds only the principal, but he may find that the contract is made so that the law treats him as the promisor.[34] To illustrate, Jackson executes a promissory note for his principal and signs it, "Jackson, Agent of Kyler." Jackson is liable on the note, as it is usually held that the words following his name are merely descriptive of the promisor and do not indicate an agency.[35]

Third Party to Agent. As a general rule, the third party is not liable to the agent for a breach of a contract which the latter makes for his principal.[36] In a few instances, however, the agent may have a right of action against the party with whom he deals for the principal.

Acting as Principal. When the agent by express agreement contracts as principal, he may bring action upon the

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[32] R., Sec. 343.
[33] *Kimball* v. *Billings*, 55 Me. 147, 92 Am. Dec. 581.
[34] R., Secs. 324 and 325.
[35] *Merchant's Bank* v. *Central Bank*, 1 Ga. 418, 44 Am. Dec. 665.
[36] R., Sec. 363.

agreement against the third party. If the agreement clearly indicates that the third person intended to contract with the agent personally, this rule applies even though the latter is known to act as an agent. An agent may also bring an action in his own name when the custom is to consider the agent as principal though his representative capacity is known.

> W. R. Smith & Son, although acting as agent of three steamship companies, purchased a quantity of coal under a contract in his own name, as principal. It was held that Smith & Son could sue on the contract. (C. G. Blake Co. v. W. R. Smith & Son, 147 Va. 960, 133 S. E. 685)

Undisclosed Principal. When the agent makes a contract for an undisclosed principal, the third party may be liable to the agent.[37] "It is too well settled to be disputed, that where a contract, not under seal, is made with an agent in his own name for an undisclosed principal, either the agent or his principal may sue upon it; the only limitation upon this doctrine being that if the principal sues upon the contract thus made with an agent in the name of the latter, the defendant is entitled to be placed in the same position at the time of the disclosure of the principal as if the agent had been the real contracting party." [38] The right of the agent, however, is subordinate to the right of the undisclosed principal, and if the latter elects to sue, the former cannot bring an action against the third person.

> The Plate Ice Company, acting for an undisclosed principal, the Hilton Lumber Company, agreed to sell specified quantities of ice to the Fruit Growers' Express Company. The Plate Ice Company was entitled to sue for breach of the contract. (Fruit Growers' Express Co. v. Plate Ice Co., 59 F. [2d] 605)

Specialties. When the agent is in his own name a party to a specialty, he alone can bring an action against the promisor.[39] Thus, when an agent, while acting for his principal, executes an instrument in his own name and under his

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[37] R., Sec. 364(a).
[38] *Oelrichs* v. *Ford*, 21 Md. 489.
[39] R., Sec. 364(g) and (h).

own seal, only he can sue on the instrument.[40] This rule is based upon the firmly established common-law rule that only parties to an instrument under seal can sue or be sued upon it. The rule applies even when the word *agent* follows the name of the party, or when it is shown at the trial that the party was in fact an agent for another.

> The rule announced by some authorities that only the agent may sue on a negotiable instrument to which the agent alone is a party, does not apply, under the Negotiable Instruments Law, Sec. 42, when the instrument is payable or indorsed to a person as "Cashier" or other fiscal officer of a bank or a corporation. (Griffin v. Erskine, 131 Iowa 444, 109 N. W. 13)

Special Interest. If the agent has a special interest in the subject matter of the contract, he may bring action against the third party.[41] For example, a factor or a commission merchant has a lien on the principal's goods in his possession for his compensation, his advancements, and his expenses; when he sells the goods, therefore, he has an interest in the subject matter of the sale that entitles him to sue the buyer on the contract of sale.[42]

> Early authorities announced that a *del credere* agent, that is, one who sells goods and guarantees to his principal payment by the buyer, may sue on the contract of sale. This rule has been questioned and repudiated. (Restatement, Agency, Sec. 372-[2], Comm. d, and Illust. 6)

Torts. The third party is liable in tort for fraudulent or other wrongful acts causing injury to the agent.[43] To illustrate, when the third party by slander or other means wrongfully procures the discharge of the agent, the latter may recover damages.[44] The agent may also bring an action in tort against the third person for wrongful injuries to his person or property. He cannot, however, bring an action in tort for

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[40] *Oliver Refining Co.* v. *Portsmouth Oil R. Corp.*, 109 Va. 513, 64 S. E. 56.
[41] R., Sec. 364(c) and (e).
[42] *Beardsley* v. *Schmidt*, 120 Wis. 405, 98 N. W. 235.
[43] R., Sec. 374.
[44] *Chipley* v. *Atkinson*, 23 Fla. 206, 1 S. 934.

injuries to the property of the principal, except when he is in the position of a bailee, thus having a right to possession.

Principal to Third Parties. The principal may become liable to third parties on actions in contract or in tort as the result of the acts of his agent. In some cases he may become liable for unauthorized acts.

Agent's Contracts. The principal is liable to third parties for all contracts lawfully entered into by his agent in his name, provided the acts of the agent were within the scope of his authority or were subsequently ratified.[45] He is also generally liable on contracts made by the agent in his behalf, although he is not known to be the principal, on the ground that he receives the benefit of the contract.[46] Another reason for his liability in such a case is that it prevents circumlocution, for if the agent were sued, he would in turn sue the principal. The principal, whether disclosed or undisclosed, cannot be held on negotiable or sealed instruments made in the agent's name.[47]

> E. C. Fishbaugh, without disclosing his principals, agreed in his own name to sell two lots to E. L. Menveg. The undisclosed principals were held liable on the contract. (Menveg v. Fishbaugh, 123 Calif. A. 460, 11 P. [2d] 438)

The undisclosed principal is not liable in these circumstances: first, when the principal has in good faith settled with the agent;[48] and, second, when the third party with knowledge of the principal elects to hold the agent.[49] Thus, when one makes a contract with another who is acting for an undisclosed principal and, on discovering the real principal, secures a judgment against the agent, he cannot hold the principal.[50]

Agent's Torts. The principal is liable to third parties for the wrongful acts of his agent committed while in his service

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[45] R., Secs. 143 and 144.
[46] R., Sec. 186.
[47] R., Secs. 151, 152, 191, and 192.
[48] R., Sec. 208.
[49] R., Sec. 209.
[50] *Murphy* v. *Hutchinson*. 93 Miss. 643, 48 S. 178.

and within the scope of the agent's employment.[51] These acts are usually the result of negligence, but the principal is sometimes liable for the willful acts of the agent. He is always liable for the fraudulent acts or the representations of the agent within the scope of his authority. To illustrate, when the agent in the routine of his authorized business issues false stock certificates, the principal is liable.[52]

> An agent sold a threshing machine as the result of fraudulent representations on his part. The buyers offered to return the machine and, when sued on notes given in payment of the price, avoided liability thereon, because the seller was chargeable with the fraud of the agent. (J. I. Case Co. v. Bird, 51 Ida. 725, 11 P. [2d] 966)

Agent's Statements. The principal is responsible for statements made by his agent while transacting business within the scope of his authority.[53] The declarations must be made at the time of performing the acts or shortly thereafter. As previously shown, such statements are not admissible to prove the agency, but they may be used to show whether the agent was acting in that capacity. Thus, if an agent states at the time of the act that he is acting as agent and not as owner, the principal is bound.[54]

> The statement of an agent in a bill of lading that goods have been received, though not so in fact, is binding on the principal when the bill has been transferred to a bona fide purchaser. (Restatement, Agency, Sec. 284)

Agent's Knowledge. The principal is bound by notice or knowledge of any fact which is acquired by a person while acting as agent within the scope of his authority.[55] This rule is extended in many cases to knowledge gained previously to the agency relation. The notice and knowledge must be in reference to matters over which the agent's authority extends and must appear to be reliable information. Thus, when the agent hears only rumors of acts or facts, the principal is not

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[51] R., Sec. 216.
[52] *Fifth Ave. Bank* v. *The Forty-Second St. and Grand Ave. Ferry R. R. Co.*, 137 N. Y. 231, 33 N. E. 378.
[53] R., Sec. 284.
[54] *Drum* v. *Harrison*, 83 Ala. 384, 3 S. 75.
[55] R.. Secs. 272 to 282 inclusive.

charged with notice.[56] The principal is not responsible for the knowledge of his agent under the following circumstances: first, when the agent, such as an attorney at law, is under a duty to another principal to conceal his knowledge; second, when the agent is acting adversely to his principal's interest; and, third, when the third party acts in collusion with the agent for the purpose of cheating the principal.

Third Party to Principal. The liability of the third party to the principal may be either in the nature of a contractual or a tort obligation. As a general rule, however, his responsibility is of the first kind.

Contracts. A third party is liable to the principal on all lawful contracts made by an agent in the name of his principal.[57] Even when undisclosed, the principal may ordinarily bring an action against the party with whom the agent deals.[58] He cannot, however, enforce sealed or negotiable instruments made by the agent in his own name.[59]

> Thomas Brothers & Co., as agent of a New York corporation, sold a quantity of bricks to a builder, Stanley Brozek. It was held that, whether the principal had or had not been disclosed, the corporation could sue on the contract. (American Enameled Brick & Tile Co. v. Brozek, 251 Mich. 7, 231 N. W. 45)

When unauthorized agreements have been subsequently ratified, there is a conflict of decisions as to the rights of the principal against the third party. One view is that the third person is not liable to the principal until the former has assented to the ratification. To illustrate, when one approves of an unauthorized contract which his agent has made with another, the latter is not liable to the principal until he assents to the affirmance.[60] The English view is that the principal has a reasonable time in which to make the defective agreement complete. As illustrated above, the principal can

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[56] *Stanley* v. *Schwalby*, 162 U. S. 255, 40 L. Ed. 960.
[57] R., Sec. 292.
[58] R., Sec. 302.
[59] R., Sec. 303.
[60] *Atlee* v. *Bartholomew*, 69 Wis. 43, 33 N. W. 110.

hold the third party on the contract, under this rule, even against his wishes, provided the ratification is made within a reasonable time.[61] The general rule in this country probably is that the contract is treated as an offer which the principal may accept.[62] Again referring to the illustration above, the principal could hold the third party on the contract, under this rule, by ratifying the unauthorized agreement within a reasonable time, provided the latter had not withdrawn.[63]

> An action brought by the third party against the agent on an implied warranty, amounts ordinarily to a withdrawal, hence a subsequent affirmation by the principal would be ineffective. (Restatement, Agency, Sec. 88, Comm. [a], and Illust. 4)

Torts. Third parties are liable to the principal for all injuries due to wrongful acts against the interests or property in the care of the agent.[64] They are also responsible to the principal in some cases for causing the agent to fail in the performance of his agreement.[65] Thus, when an agent is willfully persuaded and induced to leave an employment to which he is bound by contract, the principal may bring an action for damages against the parties causing the contract to be violated. So, also, one who colludes with an agent to defraud his principal is liable to the principal for damages.[66]

QUESTIONS

1. T. W. Howard desired to trade certain land in Missouri for a tract of land in Kansas. He employed A. S. Layton to negotiate the trade. Layton, without examining the land, reported that the tract in Kansas was of good soil and well improved. As a result, Howard ordered him to close the deal. The land in Kansas was in fact of inferior quality and had few improvements of any value. Thereafter Howard sued Layton to recover damages. Was he entitled to judgment?

2. The Wilcox & Gibbs Sewing Machine Company, of Philadelphia, Pennsylvania, employed Daniel S. Ewing to sell its sewing machines. Thereafter Ewing began selling a sewing machine that was a product

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[61] *In re Tiedemann*, 2 Q. B. 66.
[62] R., Sec. 88.
[63] *Cowan* v. *Curran*, 216 Ill. 598, 75 N. E. 322.
[64] R., Secs. 313 to 316 inclusive.
[65] R., Sec. 312.
[66] *Leimkuehler* v. *Wessendorf*, 323 Mo. 64, 18 S. W. (2d) 445.

of a competitor of his principal. After Ewing was discharged by the Wilcox & Gibbs Sewing Machine Company, he brought an action against his principal. The defendant contended that Ewing had been guilty of a breach of duty. Was this contention sound?

3. Rathborn supplies his agent, Hicks, with $500 for the purpose of investing it in bonds. Hicks purchases stocks instead of bonds. Rathborn sues Hicks for the money. Is the latter liable for this amount?

4. Tyrol authorizes Roth to sell his typewriter for $50. Roth sells the machine for $40. Tyrol sues Roth for breach of contract. Is he entitled to damages?

5. Millaudon employed Kendig, a broker, to sell certain property for him. Kendig sold the property after a lapse of several months but at a price which Millaudon believed to be too low. The latter sues for damages on the ground that Kendig did not exercise proper skill and diligence in performing his duty. Kendig's defense is that he exercised the care, skill, and diligence that is ordinarily exercised by a prudent man. Is this a valid defense?

6. Tropp received $1,000 as agent for Mann. He deposited this sum in his own personal account in a bank. The bank failed and Mann sued Tropp for $1,000. What was the decision?

7. Bowen, who knows that he has no authority, acts in behalf of Werner in executing an agreement with Moller. Thereafter when Werner refuses to carry out the terms of the agreement, Moller sues Bowen to recover damages. Is Bowen liable to Moller?

8. Cunat is authorized to sell Beeson's land for $100 an acre. While seeking a purchaser, Cunat learns that the straightening of a primary road has enhanced the value of the land to $150 an acre. Without disclosing this fact to the principal, he sells the land in accordance with his instructions. Beeson sues Cunat for damages. Is he entitled to judgment?

9. Abernathy asks Harkness, a stockbroker, to sell fifty shares of stock which he owns. Harkness makes a sale and brings action for compensation against Abernathy who claims that the broker is not entitled to remuneration because it was not mentioned at the time of the request. Does Abernathy have a valid defense?

10. Lewis is authorized to buy a bookcase for Timbers. While Lewis is returning from the place of sale, Hamlin wrongfully injures the property. Is Timbers entitled to bring an action in tort for damages?

11. Andrews, a real-estate broker, is authorized to sell a house and lot for Mapes. Nothing is said about compensation and Andrews makes a charge of ten per cent of the sale price. Five per cent of the sale price is the customary commission in that community. Is Mapes required to pay the amount claimed?

12. Keith authorizes Barclay to execute a contract with a city. Barclay in performance of this duty is required to prepare certain affi-

davits. He now demands the amount of the notarial fees from Keith. Is he entitled to this sum?

13. McGuire was authorized by Nason to sell a horse in the latter's possession. The horse did not belong to Nason, and the owner recovered its value in an action for conversion against McGuire. McGuire now sues Nason for this amount. Is he entitled to judgment?

14. Copeland is employed to act as agent for Schultz for a period of one year. After a period of six months, Copeland is wrongfully discharged. What remedies are available to him?

15. Talquith, who has been wrongfully discharged by his principal, Nelson, goes on a hunting trip during the unexpired time the agency is to continue. He later sues Nelson for damages. Is the latter liable?

16. Cummings, agent for Bradford, sells a Frigidaire to Shanks. Upon failure to deliver, Shanks sues Cummings for breach of contract. Is he entitled to recover damages from Cummings?

17. Strong, who raises and sells turkeys, is authorized to sell Dimond's turkeys. He executes an agreement to furnish Carsten with one hundred turkeys. Upon failure to deliver, Carsten sues Dimond who denies that Strong was representing him in the transaction. Carsten offers to prove that Strong stated at the time that he was acting for Dimond. Is this evidence admissible?

18. Horn, without authority, executes an agreement for Keystone with Munroe. When Keystone learns of the transaction, he expresses his approval. Is he entitled to enforce the agreement?

19. Gans is authorized to buy a farm for Messer. He executes an agreement to purchase Briggs' property without disclosing his agency. Briggs sues Gans for breach of contract. May Briggs recover damages?

20. Kerner erroneously believes that he owes a debt to Bigelow. He pays the money to the latter's agent, Grant. Immediately after making the payment, Kerner discovers that the obligation did not exist, but Grant refuses to return the money. Kerner sues Grant for the amount. Is the latter liable to Kerner?

21. Dunning, who is authorized to sell bonds for Cabell, sells Magnus ten bonds by means of fraudulent representation. Magnus sues Cabell for damages. Is he entitled to judgment?

22. Godfrey falsely represents certain facts to Barron for the purpose of inducing the latter to enter into an agreement. Upon discovering the fraud, Barron brings an action in tort for deceit against Godfrey who claims that he is not responsible as he was acting as an agent for Adams. Does Godfrey have a valid defense?

23. Arlett, who is authorized to borrow money for his principal, executes a promissory note and adds the word "Agent" after his signature. The holder of the instrument sues Arlett upon the note, which was not paid at its maturity. May he recover on the note?

Part V—Terminating the Agency

By Agreement. The relation of agency may be terminated in two general ways; namely, by act of the parties and by operation of law. The former method is perhaps the most common. It includes termination by act of either principal or agent, with or without the consent of the other.

The relation of agency is created by mutual consent, and may be terminated in like manner.[1] At any time after the establishment of the relation of principal and agent, the parties may end it by agreement. They may also provide in the original agreement for the termination of the relation at a specified time or for the termination of the agency upon the happening of a particular event.[2] Thus, when one appoints another to represent him in his business affairs while he is in Europe, the relation ends upon the return of the principal from abroad.[3] The contract may also provide for termination upon the accomplishment of the object for which the agency is created, as when it contemplates a single act only.[4]

> Sarah J. Barton requested a salesman, who had called at her farm, to carry a message with respect to the sale of certain real estate to G. D. Neavitt. It was held that upon delivery of the message the authority of the salesman to act for Mrs. Barton terminated. (Neavitt v. Lighner, 155 Md. 365, 142 A. 109)

The agency may terminate upon the expiration of a given period of time, although the object of the agency has not been accomplished.[5] The original agreement may also contain terms which give one of the parties an election to terminate the relation upon the happening of an event, or at any time upon the giving of notice or the payment of a specific sum of money.

Discharge of the Agent. The agency relation may be terminated by the act of the principal in discharging the agent.[6]

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[1] R., Sec. 117.
[2] R., Sec. 107.
[3] *Rundle* v. *Cutting*, 18 Colo. 337, 32 P. 994.
[4] R., Sec. 106.
[5] R., Sec. 105.
[6] R.. Sec. 118.

It is usually within the power of the principal to terminate the authority of the agent at any time. "The authority of the agent to represent the principal depends upon the will and license of the principal. It is the act of the principal which creates the authority; it is for his benefit and to subserve his purposes that it is called into being; and, unless the agent has acquired with the authority an interest in the subject matter, it is in the principal's interest alone that the authority is to be exercised. The agent has no right to insist upon a further execution of the authority if the principal desires it to terminate." [7]

The power to revoke, however, must be distinguished from the right to revoke. The principal possesses both the power and the right to revoke the authority of the agent when the agency is at will or when the agent becomes incompetent or is guilty of misconduct. In some instances the principal may agree not to revoke, in which case he has the power but not the right to terminate the authority.[8] For example, when an agency is established to exist for an agreed time and, before the expiration of that period, is revoked by the principal the agent is entitled to damages.[9]

> J. C. Murphy was agent of the Seattle Times Company in the city of Tacoma for the sale and distribution of newspapers. The contract of agency was terminable at the will of either party. Hence, the relation could be terminated by the principal at any time without liability to the agent. (Seattle Times Co. v. Murphy, 172 Wash. 474, 20 P. [2d] 858)

There are a few instances in which the authority once granted cannot be withdrawn by the principal. The principal is without power to revoke the authority of the agent when the agency is *coupled with an interest.* An agency is coupled with an interest when the agent has an interest in the authority granted to him or when the agent has an interest in the subject matter with which he is authorized to deal.

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[7] *Burke* v. *Priest,* 50 Mo. A. 310.
[8] R., Sec. 455.
[9] *Durkee* v. *Dunn,* 41 Kans. 496, 21 P. 637.

An agent has an *interest in the authority* when he has given a consideration or has paid for the right to exercise the authority granted to him. To illustrate, if the agent, in return for making a loan of money to the principal, is given as security authority to collect rents due to the principal, such authority cannot be revoked by the principal.[10]

> An agent was authorized to sell certain lots in the city of Des Moines. He gave no consideration for the agency and did not have an interest in the subject matter; his only interest was his right to the commission he might earn. The agency was not coupled with an interest. (Coburn v. Davis, 201 Iowa 1253, 207 N. W. 586)

An agent has an *interest in the subject matter* when for a consideration he is given an interest in the property with which he is dealing. Hence, when the agent is authorized to sell certain property of the principal and is given, as security for a debt owed to him by the principal, a lien on such property, his authority to sell cannot be revoked by the principal.

> The Pecos Valley Mercantile Company was given a mortgage lien on certain lots in the city of Roswell. The company was also given a power of sale, authorizing it to sell the lots upon the happening of certain conditions. The power of sale was irrevocable. (Cleveland v. Bateman, 21 N. M. 675, 158 P. 648)

The Restatement declares that the death of the principal does not revoke the authority of the agent under these circumstances.[11] At common law, however, this rule is generally limited to cases in which the agent is given an interest in the subject matter of the agency.

Abandonment by the Agent. Another method of terminating an agency relation is by the refusal of the agent to continue in the employment of the principal.[12] As a general rule, the agency may be brought to an end by the agent at any time. In a few instances involving unusual circumstances, the agent may be restrained from violating the contract. At

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[10] *Halloran-Judge Trust Co.* v. *Heath*, 70 Utah 124, 258 P. 342.
[11] R., Sec. 139.
[12] R., Sec. 118.

one time the general view was that contracts for personal services could not be enforced specifically, which gave the agent power to abandon his employment at any time. This rule has been modified to the extent that "where a contract stipulates for special, unique, or extraordinary personal services or acts, or where the services to be rendered are purely intellectual, or are peculiar and individual in their character, the court will grant an injunction in aid of specific performance. But where the services are material or mechanical, or are not peculiar or individual, the party will be left to his action for damages." [13]

> In a suit to obtain an injunction to prevent an agent of the Northern Pacific Railroad Company quitting his employment, the court said: "It would be an invasion of one's natural liberty to compel him to work for or to remain in the personal service of another. One who is placed under such constraint is in a condition of involuntary servitude,—a condition which the supreme law of the land declares shall not exist within the United States, or in any place subject to their jurisdiction." (Arthur v. Oakes, 63 F. 310)

The power to terminate the agency by abandonment must be distinguished from the right to terminate it, as in the case of a discharge by the principal. The agent possesses both the right and the power to abandon the relation when it is an agency at will, or when he is justified by wrongful demands or misconduct of the principal. In other instances the agent may have the power but not the right to renounce the agency.

> The M. W. Kellogg Company agreed to act as agent of the Alcorn Combustion Company for a specified term, but it renounced the contract before the expiration of that period. The agent had the power but not the right to abandon the employment; hence it was liable on the contract. (Alcorn Combustion Co. v. M. W. Kellogg Co., 311 Pa. 270, 166 A. 862)

The effect of a wrongful renunciation of the relation is to make the agent liable to the principal for damages due to the breach of contract.[14] In most states he also loses his right to compensation for services rendered. In some states he

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[13] *Rogers Mfg. Co.* v. *Rogers*, 58 Conn. 356, 20 A. 457.
[14] R., Sec. 400.

may recover the reasonable value of his services, although not in excess of the contract price minus damages sustained by the principal. In all states he is entitled to recover any salary or commission which had become due at periodic times previous to the renunciation.

By Operation of Law. Under certain conditions which render future existence of the agency impossible or undesirable, the agency is terminated by operation of law. Because of the publicity of such conditions, it is usually unnecessary to give notice to third parties.

Death. The authority of an agent is ordinarily terminated at once upon the death of the principal.[15] This is not true, however, when the authority is coupled with an interest, provided the interest is in the subject matter. If the interest is only in the agency as security, the authority is terminated by death.[16] To illustrate, when the agent is authorized to collect certain rents in the event of failure to perform an obligation on the part of the principal, the authority is terminated by death of the principal, although he could not have revoked it while living.[17]

> Julius Stalting authorized R. H. Armstrong to insert a name in a conveyance. The insertion of the name by the agent after the death of Stalting was ineffective, because the agency terminated upon the death of the principal. (Stalting v. Stalting, 52 S. D. 318, 217 N. W. 390)

The death of the agent terminates his authority, except when it is coupled with an interest.[18] In this case the exception applies to an interest in the agency to secure an obligation as well as an interest in the subject matter of the agency. In the example given in the second paragraph above, the authority of the agent to collect rents would not be terminated by the death of the agent. Termination of the agency by the death of either principal or agent creates no liability for damages, even though there is a contract of employment which ends prematurely.

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[15] R., Sec. 120.
[16] The Restatement adopts a contrary rule. Sec. 139.
[17] *Weaver* v. *Richards*, 144 Mich. 395, 108 N. W. 382.
[18] R., Sec. 121.

When performance by either the principal or the agent becomes impossible by death, the duty to perform is discharged "unless the contract indicates a contrary intention or there is contributing fault on the part of the person subject to the duty." (Restatement, Contracts, Sec. 459; Restatement, Agency, Sec. 450, Comm. [b])

Insanity. Unless the authority of the agent is coupled with an interest, the insanity of either the principal or the agent terminates the agent's authority.[19] This rule is not applied, however, when it would work an injustice to third parties who have acted in good faith and in ignorance of the affliction. In the event of either the principal or the agent being declared judicially insane, third parties are deemed to have received notice.

C. H. Hummel was authorized by a power of attorney to do certain acts. His principal subsequently became mentally incompetent. It was held that the after-occurring insanity of the principal terminated the authority of the agent. (Clark Car Co. v. Clark, 11 F. [2d] 814)

Bankruptcy. When the principal becomes bankrupt, his control and power over the subject matter cease; therefore the authority of the agent is terminated, except when it is coupled with an interest in the subject matter.[20] As a general rule the bankruptcy of the agent will also terminate the agency. Bankruptcy must be distinguished from insolvency, which generally does not terminate the relation. For example, in some states the authority of the agent is not terminated by the appointment of a receiver.[21]

Lewis Sagal & Co. was employed as agent of the Mercer Motor Company to obtain a reduction of an income assessment. It was held that upon bankruptcy of the Mercer Motor Company, the authority of the agent terminated. (Lewis Sagal & Co. v. Smith, 35 F. [2d] 182)

War. When the country of the principal and that of the agent are engaged in armed conflict, the authority of the

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[19] R., Sec. 122.
[20] R., Sec. 124. The Restatement also makes an exception when the authority is coupled with an interest in the agency. Sec. 139.
[21] *Chiletti* v. *The Missouri, Kansas and Texas Ry. Co.*, 102 Kans. 297, 171 P. 14.

agent is usually terminated, or suspended at least, until peace is restored. There are some instances, however, in which it is desirable not to apply this rule. To illustrate, the agency may not be terminated by war under circumstances in which the agent has been appointed to sell certain property situated in his or a neutral country.[22]

Effect on Agent's Powers. When the agency has been terminated in any manner, the agent loses all of his authority as between the agent and the principal. If he continues to exercise such authority, he renders himself liable to the principal. A revocation by the principal, however, is not effective until notice has been given to the agent. When the authority of the agent is terminated, he is under a duty to return all property or funds in his possession which belong to the principal.

> Thomas Pellow was agent of W. D. Rees to sell certain stock in a mining corporation. Rees revoked Pellow's authority by a letter which lay unopened for three weeks at the office of Pellow who, unknown to Rees, was on a trip to Canada. The revocation took effect from the date of delivery of the letter at Pellow's office. (Rees v. Pellow, 97 F. 167)

Termination by revocation does not deprive the agent of his power to bind the principal to third parties who have not been given notice. When the relation ends because of the expiration of the term of agency, the accomplishment of the object, or the terms contained in the contract of agency, notice need not ordinarily be given to third parties. In such cases an examination of the authority of the agent would disclose the fact that it had terminated. Notice need not, as a rule, be given to third parties when the agency terminates by operation of law, as the publicity connected with such conditions is ordinarily sufficient notice to the public.

> J. B. and W. K. Cooper were special agents to sell certain land. They sold the land to Joseph Cooper. The authority of the agents to do this single act was exhausted by doing the act authorized, even though notice is not given to third parties. (Cooper v. Cooper, 206 Ala. 519, 91 S. 82)

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[22] *Amer. Merc. Exchange* v. *Blunt*. 102 Me. 128. 66 A. 212.

Notice is not required to be given in any particular form or words, so long as the fact that the authority of the agent has ceased is brought to the attention of third parties. There is, however, a distinction made, as in the case of a partnership, in respect to the nature of the notice to persons who have dealt with the agent and to persons who have had no dealings with him.[23] Thus, "to all persons who have had actual dealings with the agent, actual notice must be given, or such knowledge of the fact must be brought home to them as would be sufficient to put an ordinarily prudent man upon inquiry. To persons who have had no actual dealings, notice may be given by publication in some newspaper of general circulation." [24] If, however, notice by publication is actually seen by persons who have dealt with the agent, it is effective as to them, although no other notice is given.

QUESTIONS

1. W. L. Skates employed Cooley for a period of six months to sell the goods that Skates had purchased from a bankrupt. At the end of six months Cooley had disposed of only three fourths of the merchandise. He then accepted another position. Skates brought an action against Cooley for breach of contract on the ground that the agency did not terminate until all of the goods were sold. Was Skates entitled to judgment?

2. Pickford was employed as the agent of Windsor for one year. His duties consisted of selling goods. After a period of six months, Windsor discharged Pickford. The latter claims that his principal has no power to discharge him, and that he can continue to sell the goods. Is his contention sound?

3. "A principal may have the power to terminate an agency but not the right to do so." What is meant by this statement?

4. It is contended that the situation is identical in cases in which the agent has an interest in the agency and in cases in which the agent has an interest in the subject matter of the agency. Do you agree?

5. Tilford borrows $1,000 from Sprague and gives the latter his watch with authority to sell it in the event the loan is not repaid. May Tilford revoke Sprague's authority to sell the watch?

6. Waring gave some stock to Lyman with authority to sell it to satisfy a debt just incurred in the event such debt was not paid. Before

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[23] R., Sec. 136.
[24] *Gragg* v. *Home Ins. Co.*, 32 Ky. L. 988, 107 S. W. 321.

the debt was paid, Waring died. Was the authority of Lyman terminated?

7. Pointon employs Yeaton for a period of five years to sell goods in a district which includes California, Oregon, and Washington. At the end of two years, Pointon sends another agent to replace Yeaton in this district and informs Yeaton that he must sell goods in an eastern district. Yeaton leaves Pointon's employment and accepts another position. Pointon sues for breach of contract. Is he entitled to damages?

8. Guilsford is employed as agent for McTague during a period of one year at a salary of $150 a month. Guilsford wrongfully abandons his agency in the middle of the seventh month, at which time his salary for the sixth month has not been paid. What are his rights to compensation?

9. Blocker executes a note for $1,000 payable to Hardwicke. At the same time he authorizes the latter, in case of a default in payment, to sell the automobile which Blocker allows his son to use. How is Hardwicke's authority to sell this machine affected, if at all, in case of the death of Blocker? in case of the death of Hardwicke?

10. Sheridan, having decided to discharge his agent, sends a letter to notify him that his authority is ended. After Sheridan has mailed the letter, the agent continues to exercise his authority. What is the latter's liability to the principal if he acted before receiving notice of the revocation of authority? after receiving notice of the revocation?

11. The American Citrus Company discharged Bardley, its purchasing agent. Thereafter Bardley entered into an agreement with G. L. Smedley for the purchase of certain goods. At the time of the agreement Smedley had no knowledge of the termination of Bardley's authority. Could Smedley hold the company on the contract?

12. Forgay employed Conrad for a period of six years to sell wheat for him. At the end of two years, the relation was terminated by agreement. Forgay published a notice in a newspaper of general circulation that Conrad was no longer his agent. After the notice appeared in the newspaper, Conrad executed an agreement for Forgay to sell two thousand bushels of wheat to Craighead. Forgay refused to deliver the wheat, and Craighead brought an action for damages. Was the latter entitled to judgment?

CASES FOR REVIEW

1. W. L. Kilbourn, as agent of McKindley and others, was authorized to make sales of his principals' merchandise. He sold certain goods to Dunham, of Berlin, Wisconsin. His principals shipped the goods with a bill upon which in large letters were stamped the words "Agents not authorized to collect." After receiving the goods and the bill, Dunham paid the price of the goods to Kilbourn, who requested the payment. The principals brought an action against Dunham to recover the price of the goods. Were they entitled to judgment? (McKindley v. Dunham, 55 Wis. 515, 13 N. W. 485)

2. Jay E. Adams authorized D. H. Walsh to sell a certain tract of land that he owned. He subsequently revoked the authority of Walsh and sold the land himself. Thereafter Walsh entered into a contract to sell the land to John K. Donnan, who knew of the sale of the property by Adams to another person. Donnan brought an action against Adams to recover damages arising out of breach of contract. Was he entitled to judgment? (Donnan v. Adams, 30 Tex. Civ. A. 615, 71 S. W. 580)

3. William T. Shearer held title to certain land for his principal, the Guardian Trust Company. At his principal's request, he conveyed the property by warranty deed to a purchaser. The buyer obtained a judgment against Shearer for breach of warranty. Thereafter Shearer brought an action against the Guardian Trust Company to recover the amount of money that he had been compelled to pay. Was he entitled to judgment? (Shearer v. Guardian Trust Co., 136 Mo. A. 229, 116 S. W. 456)

4. W. H. Tegarden and the Union Central Life Insurance Company entered into an agreement, by the terms of which Tegarden became the agent of the company in a district embracing about one half of the state of Mississippi. After serving the company for about a year and a half, Tegarden died. The administrator of the estate of Tegarden brought an action against the company to enforce the contract for the remaining eighteen and a half years. Was he entitled to do so? (Mills v. Union Cent. Life Ins. Co., 77 Miss. 327, 28 S. 954)

5. Sylvester C. Fargo and Charles G. Fargo, partners engaged in business under the name of S. C. Fargo & Son, held a promissory note executed by David G. Cravens. They authorized Byron to make a proposition to Cravens in respect to making payment in hay upon certain terms. Byron delegated the task to J. C. Schlosser. During subsequent litigation between the partnership and Cravens, it was contended that Byron could not rightfully delegate his duty to another without the consent of the principals. Was this contention sound? (Fargo v. Cravens, 9 S. D. 646, 70 N. W. 1053)

6. Booth entered into a contract to purchase a quantity of asphalt blocks from the Barber Asphalt Paving Company. In the transaction he was acting as the agent of an undisclosed principal, the Kelly Asphalt

Block Company. The blocks that were delivered pursuant to the contract proved to be defective and unmerchantable. The Kelly Asphalt Block Company brought an action against the Barber Asphalt Paving Company to recover damages arising out of breach of contract. Was it entitled to enforce the agreement? (Kelly Asphalt Block Co. v. Barber Asphalt Paving Co., 211 N. Y. 68, 105 N. E. 88)

7. The Union Charcoal & Chemical Company, a New York corporation, operated a small branch plant near the city of Memphis, Tennessee. It employed Alt, whose principal duty was to see that four Negroes were kept busy at grinding and sacking charcoal. In an action brought by E. J. Kennedy against the company, it was contended that Alt was not an agent of the company. Do you agree with this contention? (Kennedy v. Union Charcoal & Chemical Co., 156 Tenn. 666, 4 S. W. [2d] 354)

8. George Kramer authorized R. C. Winslow to sell a certain interest in a tract of land located in Jefferson County, Pennsylvania, for the sum of $7,500. Winslow secretly contracted to sell the interest for $11,124. Without informing Kramer of the deal, Winslow induced Kramer to convey the interest to him and thereafter conveyed the interest to the buyer. Kramer later brought an action against Winslow to recover the sum of $3,624, the difference between the amount paid for the interest and the amount Winslow led him to believe was being paid. Was he entitled to judgment? (Kramer v. Winslow, 130 Pa. 484, 18 A. 923)

9. W. H. Meadows owned a farm in Arkansas. A certain crop in which he had an interest became very grassy. Meadows told his tenant to employ some person to work the crop. The tenant hired J. W. Hudson to do the work. Thereafter Hudson brought an action against Meadows to recover compensation for his services. He contended that the tenant, when employing him, had acted as an agent of Meadows. Was Hudson entitled to judgment? (Meadows v. Hudson, 90 Ark. 294, 119 S. W. 269)

10. John S. Green authorized Follett to convey a tract of land consisting of one hundred and twenty acres. Green died, and thereafter Follett executed a deed conveying the land. In an action brought by E. D. Tuttle and I. E. Solomon against Rhoda P. Green and others, it was contended that the deed executed by Follett was void and inoperative. Do you agree with this contention? (Tuttle v. Green, 5 Ariz. 179, 48 P. 1009)

11. Waggoner was a salesman for the Providence Jewelry Company. As the result of a fraud perpetrated by him, he induced S. Fessler & Sons to sign a contract for the purchase of some cheap jewelry at the aggregate price of $263.60. Thereafter the Providence Jewelry Company brought an action against S. Fessler & Sons to enforce the agreement made through Waggoner. Was the Providence Jewelry Company entitled to judgment? (Providence Jewelry Co. v. S. Fessler & Sons, 145 Iowa 74, 123 N. W. 957)

12. O. W. Underwood owned a certain tract of land in the state of Minnesota. He authorized A. B. Wilgus & Bro., a partnership composed of A. B. Wilgus and E. P. Wilgus, to sell the foregoing property. The firm made a contract with Deakin, who agreed to purchase the land. Thereafter Deakin brought an action against Underwood to obtain specific performance of the agreement. Did the authorization of the firm to sell the land create a valid relation of agency? (Deakin v. Underwood, 37 Minn. 98, 33 N. W. 318)

13. Bernard A. Buge owned certain premises in the state of New York. His agent, Lyon, leased the property to Minnie F. Newman. The lease was signed and sealed by the tenant and by Lyon in his own name. Thereafter Buge brought an action against Mrs. Newman to collect the rent under the contract. Was he entitled to do so? (Buge v. Newman, 61 Misc. Rep. 84, 113 N. Y. S. 198)

14. The Consolidated Fuel Company authorized Frank L. Butterfield to sell certain bonds. The company promised to pay Butterfield a certain commission upon the sale of the bonds. Thereafter the company notified Butterfield that his authority was terminated. During subsequent litigation between the parties, Butterfield contended that the fuel company had no power to revoke the authority granted to him. Do you agree with this contention? (Butterfield v. Consolidated Fuel Co., 42 Utah 499, 132 P. 559)

15. Nash, Wright & Company, grain dealers, operated an elevator in the state of Illinois. Smith was placed by the company in charge of the elevator. Smith made an agreement to purchase certain corn from Class Classon. Thereafter the company repudiated the agreement on the ground that Smith had no authority to bind it by such an agreement. Was the company's stand well taken? (Nash v. Classon, 163 Ill. 409, 45 N. E. 276)

16. Henry R. Day, as an agent of Simeon B. Shoninger and another, dealers in musical instruments in New Haven, Connecticut, made an unauthorized sale of a piano to Frederick O. Peabody. The terms of the agreement provided that Peabody was to pay for the instrument out of commissions earned by carrying on stock transactions for Day. When the dealers learned of the sale and the terms, they immediately brought an action to recover the unpaid purchase price, although Peabody's commissions had not reached this amount. Were the dealers entitled to judgment? (Shoninger v. Peabody, 57 Conn. 42, 17 A. 278)

17. Elizabeth Browne Casey, an infant, left a certificate representing certain shares in the United States Steel Corporation with Philip F. Kastel, with an assignment executed in blank. Thereafter she approved of a sale of the stock by Kastel to Johnson & Wood. When Miss Casey subsequently sought to recover the value of the stock from Kastel and others, it was contended that the authorization to sell the stock was void. Do you agree? (Casey v. Kastel, 237 N. Y. 305, 142 N. E. 671)

18. Mary E. Spencer appointed her husband as agent to procure a loan for her from the Southern Exchange Bank. He procured the loan, all papers incidental thereto were signed, and the money was delivered. The notes given by Mrs. Spencer were subsequently purchased by the Atlanta Savings Bank, at which time Mr. Spencer allegedly told the bank that the notes were "all right." The notes proved to be defective. The Atlanta Savings Bank, attempting to hold Mrs. Spencer bound by the statement of her husband, contended that her husband was her agent at the time of making the statement. Do you agree? (Atlanta Sav. Bank v. Spencer, 107 Ga. 629, 33 S. E. 878)

19. Sexsmith was authorized by the California Development Company to contract in behalf of the company for the use of a certain dipper dredge owned by the Yuma Valley Union Land & Water Company. He was privately instructed, however, not to make the agreement unless the owner insured the machine. The Yuma Valley Union Land & Water Company, without knowledge of the instructions, leased the machine, which was not insured. In an action brought by the Yuma Valley Union Land & Water Company to recover damages for breach of contract, the California Development Company contended that it was not bound by the agreement made by Sexsmith. Do you agree? (California Development Co. v. Yuma Valley U. L. & W. Co., 4 Ariz. 366, 84 P. 88)

20. A. S. Holderness employed John Phelps & Company to act for him in a gambling operation involving the rise and the fall of the price of cotton. Thereafter Phelps brought an action against Holderness for the purpose of recovering certain money alleged to be due as compensation under the agency agreement. Was he entitled to judgment? (Phelps v. Holderness, 56 Ark. 300, 19 S. W. 921)

21. Mrs. Patrick Shields brought an action against Coyne to recover damages arising out of breach of contract. She alleged that in her behalf her husband had entered into an agreement whereby Coyne had promised to make a loan of $9,600 to her so that she might purchase a certain tract of land. Who had the burden of proving the alleged relation of agency? (Shields v. Coyne, 148 Iowa 313, 127 N. W. 63)

22. J. H. Liddell and others formed the Co-operative Association of Green County, Arkansas. The association employed R. A. Briggs to manage and transact its mercantile business. In an action brought by D. A. Sahline & Company, a creditor of the association, it was contended that Briggs was a general agent. Do you agree with this contention? (Liddell v. Sahline, 55 Ark. 627, 17 S. W. 705)

23. John Floyd and others, without authority, undertook to act in behalf of the Wool Growers Exchange. As agents for the exchange they entered into an agreement with the Farmers' Co-operative Trust Company for the purchase of over thirty-one thousand pounds of wool. After discovering the agents' lack of authority, the trust company brought an action against Floyd and the other agents. Were the agents under any

liability to the trust company? (Farmers' Co-operative Trust Co. v. Floyd, 47 Ohio St. 525, 26 N. E. 110)

24. J. W. Thompson obtained a contract to build a tunnel under two railroad tracks in the city of Houston, Texas. He put A. I. Skene in charge as superintendent of the entire work. Skene entered into a contract with N. L. Mills for the disposal of the earth to be excavated. When sued by Mills, Thompson contended that he was not bound by the agreement made by Skene with Mills. Was this contention sound? (Thompson v. Mills, 45 Tex. Civ. A. 642, 101 S. W. 560)

25. J. H. Russell made certain statements and representations to an agent of the Powerine Company. He knew that the agent was acting adversely to the interests of his principal, and not in accordance with instructions of his principal. It was contended that the knowledge of the agent as to the foregoing statements and representations was binding on the principal. Was this contention sound? (Powerine Co. v. Russell's, Inc., 103 Utah 441, 135 P. [2d] 906)

26. An agent, acting for and in behalf of the Northwest Atlanta Bank, without disclosing his agency made a contract to purchase certain goods from E. M. Willingham. The goods were delivered. Thereafter Willingham discovered the agency. Was he entitled to hold the bank on the contract for the amount of the purchase price? (Northwest Atlanta Bank v. Willingham, 69 Ga. A. 258, 25 S. E. [2d] 154)

27. Blanche Trembley, as agent, entered into a contract with the Puro Filter Corporation of America in the name of Trembley, Inc. There was no corporation existing with the name of Trembley, Inc. The Puro Filter Corporation brought an action against the agent to recover on the contract. Was it entitled to hold the agent on the contract? (Puro Filter Corporation v. Trembley, 266 App. Div. 750, 41 N. Y. S. [2d] 472)

CHAPTER III

EMPLOYER AND EMPLOYEE

Part I—General Considerations

Introduction. Practically every businessman is to a greater or lesser extent in the position of employer. Even in early days during the development of the common law, when economic society was organized along simple lines, it was not unusual for one person to be employed by another to perform certain services. Today, in by far the majority of businesses, the businessman engages the time and efforts of others in his behalf. Indeed, the magnitude and complexity of our modern business organizations compel the entrepreneur to use, as a general rule, the services of a large number of persons.

The relation of employer and employee is technically known as that of master and servant. Because of much confusion in respect to the meaning of the latter terms, there is some objection to their use. The terms *employer* and *employee* are therefore more commonly used in the terminology of modern decisions and statutes. In this text master and servant will be used interchangeably with employer and employee.

The relation of employer and employee gives rise to many questions involving the rights and obligations of the parties. These questions arise in connection with the creation of the contract of employment, the rights and duties between the employer and the employee, and the rights and duties between the employer and third persons. These problems are still governed by common-law rules in many, many cases, notwithstanding modern labor laws.

The subject will not be discussed in full, however, because many of the rules governing the relation of employer and employee are also applicable to the relation of agency and were therefore discussed in Chapter II. The rules peculiar to the relation of employer and employee are mainly in respect to the duties and liabilities of the employer.[1]

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[1] Restatement of the Law of Agency (hereinafter cited as R.), Sec. 2(a).

Definitions. The relation of employer and employee is established by an express or implied agreement, under which one person undertakes to perform personal services under the direction and control of another.[2] An *employer* has been defined as "one who not only prescribes the work, but directs, or at any time may direct, the means and methods of doing the work." [3] An *employee* has been defined as "one who is employed to render personal services to his employer, otherwise than in the pursuit of an independent calling, and who in such service remains entirely under the control and direction of the latter." [4]

> A dentist, employed on a weekly salary to assist another dentist, was not the latter's agent but "was, strictly speaking, his servant or employee." (Wightman v. Wightman, 223 Mass. 398, 111 N. E. 881)

The distinguishing characteristic of the relation is that the master or employer exercises direction and control over the activities of the servant or employee. If this characteristic is kept in mind, other employments of somewhat similar nature may be distinguished. In this respect a servant differs from an agent in that the latter acts for and in the place of the master, but not under his direction and control. Thus he may also be differentiated from the independent contractor who, although performing personal services, is not under the immediate direction and control of the employer. To illustrate, one contracting to build a house for another ordinarily has full power as to the determination of the means and methods of doing his work. In such a case the relation of master and servant does not exist between the employer and the contractor or his employees.[5]

Creating the Relation. The relation of master and servant is based upon agreement; therefore it does not exist in the absence of assent on the part of both parties. Thus one does not become the servant of another merely because he volun-

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[2] R., Sec. 2.
[3] *Bailey* v. *Troy, etc., R. R. Co.*, 57 Vt. 252.
[4] *Hedge* v. *Williams*, 131 Calif. 455, 64 P. 106.
[5] *Hennebry* v. *Maynard*, 174 Mass. 428, 54 N. E. 871.

tarily acts in that capacity.[6] The assent of the employer is as essential as that of the employee.[7] "A person who goes to the house of another to share the benefits and hospitality of the family cannot at his own will and pleasure convert himself into a hired servant without the knowledge or consent of the head of the family." [8]

> "The relation of master and servant cannot be imposed upon a person without his assent, express or implied." (Corbin v. George, 308 Pa. 201, 162 A. 459)

The contract upon which the relation is based is governed in general by the rules applicable to all other enforceable agreements. Any party competent to contract may enter into a relation either as master or servant. As a general rule the contract may be oral or written. In some situations, however, it is required to be in a particular form. For example, when the relation is based upon a contract of employment which cannot be performed within the space of one year, the agreement must be in writing.[9] The contract of employment, unless required to be in writing, may be either expressed or implied.

> When a person offered to deliver papers for a publishing company, but the offer had not been accepted, the unaccepted offer was "not sufficient to make the offeree an employee." (Sumner v. Edmonds, 130 Calif. A. 770, 21 P. [2d] 159)

The assent of the master necessary to establish the relation may be inferred from his conduct. Thus it was held that when a minor worked with his father in a mine under the supervision of the company's agent, the company impliedly assented to the relation of master and servant, even though the minor's name was not on the payroll.[10] In a similar case the court stated that "even though there was no direct contract of employment, the plaintiff was entitled to the protection of a servant, if, with the knowledge and consent of the

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[6] *Taylor* v. *Baltimore, etc., R. R. Co.*, 108 Va. 817, 62 S. E. 798.
[7] R., Sec. 221.
[8] *Grubb* v. *Block*, 1 Ky. 501.
[9] *Ante*, Chapter 1, p. 133.
[10] *Tenn. Coal, etc., R. R. Co.* v. *Hays*, 97 Ala. 201, 12 S. 98.

defendants, he was in the mine for the purpose of rendering services for their benefit, and the case should be presented to the jury upon that theory." [11]

Terms of Employment. Courts under the common law place practically no restraint upon the parties in respect to the terms of employment. Of course, as indicated above, the agreement, like all other contracts, must be legal. Thus, the relation of master and servant cannot be based upon a contract, the terms of which provide for acts which are illegal. If, however, the purpose for which the employee is engaged is legal, courts seldom interfere with the terms of the contract, as between the parties themselves, in respect to such matters as hours of service or method of payment.

> "The master has the right to fix the terms and conditions upon which he is willing to give employment; the servant has the right to fix the terms and conditions upon which he will labor." (Goldfield Consol. Mines Co. v. Goldfield M. U. No. 220, 159 F. 500)

One exception to the general rules just stated must be considered. Let us assume that the terms of the employment contract stipulate that the master will not be liable for injuries due to his negligence. Whether this provision at common law is invalid, as being contrary to public policy, is a question about which there is a difference of opinion. Thus, in England and in at least one of our states, it is held that such provision is not inconsistent with public policy, because only the interests of the servant are affected.[12] On the other hand, most of our states have taken a contrary view. One court states: "If it were true that the interests of the employed only, would be affected by such contracts as the present one, as held by the English court, in *Griffiths* v. *Earl of Dudley*,[13] it would be difficult to defend, upon sound reasoning, the denial of the right to enter into them; but that is not quite true. The theory of their invalidity is in the importance to

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[11] *Ringue* v. *Oregon Coal Co.*, 44 Oreg. 407, 75 P. 703.
[12] *Western, etc., R. R. Co.* v. *Bishop*, 50 Ga. 465.
[13] L. R.. 9 Q. B. Div. 357.

the state that there shall be no relaxation of the rule of law, which imposes the duty of care on the part of the employer toward the employed. The state is interested in the conservation of the lives and the healthful vigor of its citizens, and if the employers could contract away their responsibility at common law, it would tend to encourage on their part laxity of conduct in, if not indifference to, the maintenance of proper and reasonable safeguards to human life and limb." [14]

QUESTIONS

1. "The magnitude and complexity of our modern business organizations compel the entrepreneurs to use, as a general rule, the service of a large number of persons." Do you agree with this statment?

2. Van Dyke and Rohn are reviewing together for an examination in a course which deals with labor problems. The former states that the term *servant* technically means one who is engaged for domestic service. Rohn maintains that the term *servant* is properly used to describe anyone who is employed by another. Do you agree with Van Dyke or Rohn?

3. F. V. Johnson, James Chapman, and M. D. Burris entered into an agreement to sink a mining shaft for the Swansea Lease, a corporation. They agreed to sink the shaft a depth of five hundred feet, for which they were promised $34 a foot of depth. During performance of the agreement, Chapman by accident suffered an injury that resulted in his death. His administratrix, Anna C. Mollory, brought an action against the corporation. She contended that Chapman had been an employee of the defendant. Was this contention sound?

4. The Star News Company employs Stewart to solicit subscriptions for certain magazines. His duty consists of taking orders for these periodicals by means of a house-to-house canvass in a given district. Is the relation of employer and employee established between the company and Stewart?

5. Indicate which of the following persons are agents and which are employees: a cashier of a bank; a streetcar motorman; a bond salesman; a building contractor; a cattle buyer; a fruit picker.

6. The Superior Film Corporation hires Shellhouse for a period of one year to paint scenery. Shellhouse is discharged when it is discovered later that he is only twenty years of age. In an action for breach of contract, the company alleges that it was not bound by the agreement because of Shellhouse's infancy. Is this a valid defense?

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[14] *Johnson* v. *Fargo*, 184 N. Y. 379, 77 N. E. 388.

7. Gwin is employed by Unroe to do odd jobs around his home. One day he is directed to paint the garage. Unknown to Unroe, Shuey, who lives nearby, assists Gwin in painting the building. Before the task is completed, Shuey is injured by falling from a ladder. He now demands compensation for his injuries from Unroe, basing his claim upon a relation of employer and employee. Unroe denies that Shuey was his employee. Do you agree?

8. Reisner fraudulently induces Thorn to execute a contract of employment. The latter, upon discovery of the fraud, refuses to perform. An action for damages is brought by Reisner against Thorn. Is he entitled to judgment?

9. Hanley orally agrees to assist Condon in harvesting a wheat crop fourteen months from date. Later he refuses to perform, and Condon sues him for breach of contract. Is the latter entitled to damages?

10. Hauberstadt hires a crew of eight men to move a house. While the task is being performed, Perigo joins the crew and labors daily with them under the supervision of Hauberstadt. On account of a defective appliance, Perigo receives a serious injury. He now maintains that he is entitled to the protection of a servant. Is his contention sound?

11. The Blackbird Coal Company, engaged in operating a coal mine in Adair County, Missouri, employed Daniel F. Jarrell, an experienced miner. Jarrell was injured by a landslide, which could have been prevented by the use of false cribbing. In an action by Jarrell against the coal company, it was contended that an agreement between the parties to relieve the company from responsibility for its own negligence is void. Do you agree?

Part II—Duties and Liabilities of Master

Duties of the Master. At common law the master is not an insurer of the employee's safety.[1] He has no responsibility for injuries resulting from the perils of the industry. His liability, in general, is only for injuries arising in and from the course of employment, which originate from his own negligence. This obligation is imposed by law as incidental to the relationship.

Care. An employer is liable to his employee for injuries which result from a failure to exercise due care.[2] "He is only required to exercise such ordinary and reasonable care for the safety of his servants as the nature and dangers of the business demand." [3] Whether the master has exercised ordinary care depends, then, upon two elements: first, whether he has acted as an ordinarily prudent man; and, second, whether he has acted as such a man would act under the particular circumstances. In respect to the latter, it is clear that conduct which constitutes ordinary and reasonable care in one instance might not in another. Thus, in a business which requires the use of dangerous explosives, reasonable care by the employer to protect the employee from injuries requires a high degree of diligence.[4]

> With respect to matters not covered by the Safety Appliance Acts, an "interstate carrier owes to the employee only what we call ordinary care." (Cockran v. Pittsburgh & L. E. R. Co., 31 F. [2d] 769)

Place of Work. The master is under a duty to furnish his servants with a reasonably safe place in which to do his work. The place of work includes not only the premises occupied while the servants are working, but also such other parts of the premises as may be used by the employees under express or implied permission or invitation of the employer.[5] For example, a dressing room for the employees must be reasonably

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[1] R., Sec. 492(c).
[2] R., Sec. 493.
[3] *Smith* v. *United Lumber Co.*, 71 W. Va. 741, 77 S. E. 333.
[4] *Froeburg* v. *Smith*, 106 Minn. 72, 118 N. W. 57.
[5] R., Sec. 497.

safe.[6] "A master's duty in respect to furnishing his servants with a safe place in which to work extends to such parts of the premises only as he has prepared for their occupancy while doing his work, and to such other parts as he knows or ought to know they are accustomed to use while doing it." [7] An employer is not liable, however, for the lack of a safe place in which to work where the employees are engaged in erecting or tearing down structures, and the nature of the work creates temporarily hazardous conditions. In such situations the place is as safe as can reasonably be expected.

> When an employer furnishes suitable materials and does not supervise the building of a scaffold by his employees, he is not liable for the negligent construction of such scaffold. (Fraser v. Norman, 184 Ark. 434, 42 S. W. [2d] 569)

Tools and Appliances. The master is also under a duty to furnish his employees with reasonably safe tools and appliances necessary in the performance of the particular work.[8] The employer is not obliged to furnish the safest or best tools, machinery, or appliances. "The employer does not undertake with the employee that he will use the very best appliances, nor is he called upon to discard machinery adapted by him in his business, that is reasonably suited therefor, although there may be other machinery that is safer. He is bound to exercise reasonable care in providing the machinery and appliances in view of all the circumstances. Still less is the master to be cast in damages for error of judgment in selecting one method of prosecuting his business, or one kind of machinery or appliance, on proof that another method or appliance is better or safer, when both methods or both kinds of appliances are in common use." [9]

> The employer was liable for an injury due to a defective electric cord which it furnished to an acetylene welder engaged in repairing a ship. (Colonna Shipyard v. Dunn, 151 Va. 740, 145 S. E. 342)

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[6] *Flynn* v. *Prince, etc., Co.*, 198 Mass. 224, 84 N. E. 321.
[7] *Harris* v. *Det Forenede Dampskibsilskof*, 75 N. J. L. 861, 70 A. 155.
[8] R., Sec. 502.
[9] *Sisco* v. *Lehigh, etc., Ry. Co.*, 145 N. Y. 296, 39 N. E. 958.

The master is under no duty to furnish the newest tools, machines, or appliances. As one court stated, "We do not say that defendants must be the 'first by whom the new is tried,' but they should take care to see that they are not the 'last by whom the old is laid aside.' " [10] Indeed, the master may render himself liable by experimenting with new machines and appliances. "An employer, before adopting and installing a new and untried appliance, is required to select that which seems to be the safest and most suitable for his purposes, and to consult the best available known sources of information for reliable advice as to the wisdom of the proposed experiment. A failure to take these precautions, should the device selected prove defective and an accident occur from its use, will be regarded as culpable negligence." [11]

Sufficient Competent Employees. Another duty of the master is to employ a sufficient number of competent employees for the task at hand.[12] He must exercise reasonable care in selecting and retaining competent employees, and he is liable for any injuries resulting from a failure to do so. Whether a servant is incompetent depends on the particular work assigned to him. Infancy, physical incapacity, inexperience, lack of training, or inability to speak the English language does not necessarily establish incompetency. "The selection of a servant must, of course, be made with a view to the nature of the employment. If it involves special knowledge or experience, only men of special knowledge and experience should be employed." [13] In determining whether the master has exercised proper care, it must be remembered that " 'incompetency' is not confined to a lack of physical capacity, or natural mental gifts, or of technical training when such training is required; but it extends to any kind of unfitness which renders the employment or retention of the servant dangerous to his fellow servant, and includes habits of carelessness or inattention in work where such habits or methods are not unlikely to result in injury." [14]

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[10] *Lynch* v. *Dewey Bros., Inc.*, 175 N. C. 152, 95 S. E. 94.
[11] *U. S. Express Co.* v. *Ball*, 36 App. (D. C.) 269.
[12] R., Sec. 505.
[13] *Holland* v. *Tennessee Coal, etc., R. R. Co.*, 91 Ala. 444, 8 S. 524.
[14] *Walters* v. *Durham Lumber Co.*, 163 N. C. 536, 80 S. E. 49.

Actual knowledge of incompetency of a winch driver is not required to render an employer liable, "if that incompetency should have been known" to him. (Roswall v. Grays Harbor Stevedore Co., 138 Wash. 390, 244 P. 723)

The master must not only furnish competent fellow servants, but also a sufficient number of them to carry out the particular task or service. "It is the duty of the master to employ a sufficient number of servants to do the work in which they are employed with reasonable safety to themselves." [15] He is liable for the injuries arising from his failure in this respect or from his failure to maintain a sufficient number. Thus, if the employer originally supplies an adequate number of competent servants for a given task, but later withdraws some of them before they can be spared with safety, he is liable for injuries which are approximately caused by the insufficiency of servants.[16]

Instructions. The master must also give special instructions to his servants as to unusual dangers peculiar to the business.[17] "This rule applies to latent and extraneous dangers of which the master himself has knowledge, or of which, with exercise of ordinary care, he should have had knowledge." [18] Another limitation on the general rule is that the master need not give instructions and warning when the servant has knowledge of the dangers, or when such dangers are of common knowledge and the servant should know of them. Nor is the master under a duty to warn the servant of obvious dangers. For example, moving machinery is a danger of which the master need give no warning.[19] In a case of this kind the court stated: "No grown person, whatever his schooling or lack of schooling, could fail to appreciate that a machine that would trim the edges of boards as those were trimmed would seriously injure one's fingers if they got into it. Machines speak a universal language, and the operating parts of this one spelled danger to fingers coming in contact

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[15] *Jirmasek* v. *Payne*, 151 Minn. 421, 186 N. W. 814.
[16] *Stewart* v. *Stone, etc., Eng. Corp.*, 44 Mont. 160, 119 P. 568.
[17] R., Sec. 510.
[18] *Bone* v. *Ophir Silver Mining Co.*, 149 Calif. 293, 86 P. 685.
[19] *Boyd* v. *Taylor*, 195 Mass. 272, 81 N. E. 277.

therewith just as clearly in the Lithuanian tongue as they did in English. It was equally obvious to him, as it was to the defendant, that his hands might slip from the edges of the boards if he pushed against them. For these reasons it must be held that no duty devolved upon the defendant to warn the plaintiff." [20]

Risks of Industry Doctrine. The master is not liable for injuries to his servants arising out of the ordinary risks or dangers of employment. "Whatever is necessary to be done in the work in which the servant is engaged is incident to the servant's employment, and whatever risks and dangers attach to it, he assumes." [21] This rule is known as the doctrine of *assumption of risk.* There are several theories as to the basis of this doctrine. Some courts maintain that there is an express or implied agreement that the employer shall not be liable for such injuries. Others deny this basis of the doctrine, claiming that the doctrine is based upon the principle that one cannot complain of that to which he assents. Another theory offered is that public policy requires the doctrine in order to secure greater care on the part of the employee.

Ordinary Risks. The doctrine announced above applies only to ordinary risks. Such risks are the dangers of a particular business which cannot be prevented by the employer with the exercise of reasonable care.[22] It is immaterial that the dangers are of a peculiarly hazardous nature, if they are incidental to the service. "Many employments are by their nature dangerous, some are very dangerous; but such employments because of their dangers are not therefore unlawful, nor is the rule of the assumption of risks on the part of the employee changed or modified according to the varying degrees of the danger of the employment, as the servant is presumed to have contracted with reference to all the hazards and risks of such employment." [23] Thus a raftsman employed to float

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[20] *Montenilla* v. *Northern Furniture Co.*, 153 Wis. 292, 141 N. W. 279.
[21] *Neville* v. *Bosal*, 166 N. C. 218, 81 S. E. 448.
[22] R., Sec. 499.
[23] *Louft* v. *C. & J. Pyle Co.*, 24 Del. 192, 75 A. 619.

logs down a stream assumes the risk of injuries due to the dangers connected with the water while performing his duties.[24]

> When a caddy sued for an injury from a golf ball driven by one not his employer, the court refused the defense of assumption of risk, saying: "The doctrine of assumption of risk is contractual in its nature, and rests upon an agreement of a servant with his master." (Biskup v. Hoffman, 220 Mo. A. 542, 287 S. W. 865)

Unusual Risks. A servant does not assume risks caused by the failure on the part of his master to perform those duties set forth in the previous section, except as noted hereafter. The risks which are caused by the master are classed as unusual risks. Such risks may, however, be assumed by the servant under three conditions. First, the servant assumes such risks when he knows or should know that certain defects which the master should remedy exist, but continues voluntarily in the employment without complaint.[25] "Where a defect is known to the employee, or is so patent as to be readily observed by him, he cannot continue to use the defective apparatus in the face of knowledge and without objection, without assuming the hazard incident to such situation." [26] Second, the servant assumes such danger when notice of it is brought to the attention of the master but the latter makes no promise to repair the defect. For example, where the employee complains of a dangerous condition and continues to work without any assurance that it will be removed or after a refusal on the part of the master to remove it, the servant assumes the risk.[27] The third exception arises in connection with a promise to repair the defect, made on the part of the employer.

> Risks that could be obviated by the use of reasonable care on the part of the employer are not assumed by the employee, unless obvious or known. (Tynes v. Atlantic Coast Line R. Co., 149 S. C. 89, 146 S. E. 663)

Promise to Repair. If the master makes an unconditional promise to repair the defect, and the servant in reliance

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[24] *Waterman* v. *Skokomish Timber Co.*, 65 Wash. 234, 118 P. 36.
[25] R., Sec. 521.
[26] *Choctaw, etc., R. R. Co.* v. *McDade*, 191 U. S. 64, 48 L. Ed. 96.
[27] *Lamson* v. *American Axe, etc., Co.*, 177 Mass. 144, 58 N. E. 585.

thereon continues to work, the latter does not assume the risk of the danger.[28] "It is the well-established law that for a certain time a master may remain liable for a failure to use reasonable care in furnishing a safe place to work, notwithstanding the servant's appreciation of the danger, if he induces the servant to keep on by a promise that the source of trouble shall be removed." [29] If the promise to repair by a certain time is made, the servant assumes the risk after the lapse of such time. If no time is stated, the employee does not assume the risk until after the lapse of a reasonable time.

Fellow-Servant Doctrine. At common law the master is not liable to his servant for injuries which are caused by another servant while at work. This is known as the *fellow-servant doctrine.* It is generally considered a part of the assumption of risk doctrine. "The negligence of one's fellow servant is an assumed risk, growing out of the supposed agreement of the laborer with his employer to assume all risks which are incidental to the work to be engaged in after the master has performed his primary duties in the premises." [30] This rule does not apply, however, when the injury is due to the failure of the master to furnish and retain sufficient competent servants.

Who Are Fellow Servants? It is frequently difficult in applying the doctrine set forth above to determine who are fellow servants. The definition of the term which is generally accepted is that fellow servants include all who are employed by a common master to further the same general business.[31] Thus it has been held that the brakeman of one train and the engineer of another of the same company are fellow servants.[32]

Departmental Rule. A few courts have limited the definition stated in the preceding paragraph to servants working in the same department. Under this rule those who do not

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[28] R., Sec. 522.
[29] *Southwestern Brewery, etc., Co.* v. *Schmidt,* 226 U. S. 162, 57 L. Ed. 170.
[30] *North-East Coal Co.* v. *Preston,* 132 Ky. 262, 116 S. W. 704
[31] R., Sec. 475.
[32] *Peters* v. *Southern Pac. Co.,* 160 Calif. 48, 116 P. 400.

work in the same department are not fellow servants.[33] To illustrate, a motorman of one car is not a fellow servant of the motorman of another, although both are employed by the same master and are engaged in furthering the same business.[34] The departmental rule is usually applied only when the enterprise is of huge size. It has not been generally adopted, however, because of the difficulty in determining what constitutes a department. In respect to the latter, it has been stated that "when the services of two servants are so widely separated, so wanting in contact, that some unusual event must occur to direct the results of the negligence of the one to the other, the two are said to belong to different departments." [35]

Association Rule. Another test used in deciding who are fellow servants is to determine whether the employees are cooperating in a particular task or whether their ordinary duties necessarily cause habitual association, thus affording the opportunity of mutual influence promotive of due care. For example, under this doctrine painters are not fellow servants of the carpenters who constructed the scaffolds upon which the former work, but the men working on the scaffolds are fellow servants of each other.[36] This rule is called the *association* or *conassociation* doctrine. It, however, has not been accepted generally.

Vice Principals. Employees who are entrusted with carrying out the duties of the master, set out above, are not fellow servants of the other employees. They are called *vice principals.* They perform duties of the master which are said to be nonshiftable; and if they fail to carry out these duties, thus causing an injury, the master cannot escape liability under the fellow-servant doctrine. "It is universally held that the duty rests upon the employer to exercise care to furnish his employees reasonably safe tools and working appliances.

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[33] The Restatement states that some employees of one department, and not others, may be fellow servants of employees in a different department. Sec. 478.

[34] *Milton* v. *Frankfort, etc., Tract. Co.,* 139 Ky. 53, 129 S. W. 322.

[35] *Lukic* v. *Southern Pac. Co.,* 160 F. 135.

[36] *World's Columbian Exposition* v. *Lehigh,* 196 Ill. 612, 63 N. E. 1089.

If this duty is shifted to a subordinate who fails to observe it, and a servant is injured in consequence of the failure, the subordinate will be regarded as the representative of the master in so far that the particular neglect will be treated as the master's and not a fellow servant's, and damages may be recovered by the employee." [37] It must be remembered that whether a subordinate is a vice principal depends upon the nature of the service performed, rather than the position or the name of the employee; hence one can change his relation to the other employee from vice principal to fellow servant, or vice versa, during the day.[38]

Superior Servant Rule. Some states have adopted a rule that workmen are not fellow servants where one is under the control of the other. This is called the *superior servant rule.* The basis of this rule seems in some instances to be the same as in the case of the vice principal; namely, that the superior servant is performing a duty of the master which cannot be delegated. In other cases it is placed upon the right of the superior servant to obedience. "His position is one of superiority. When he gives an order within the scope of his authority, if not manifestly unreasonable, those under his charge are bound to obey, at the peril of losing their situations, and such commands are, in contemplation of law, the commands of the company, and hence the latter is held responsible for the consequences." [39] The rule is not satisfactory and has not been adopted by many states.

Contributory Negligence Doctrine. The master is not, generally speaking, liable to his servants for injuries due to his negligence where the employee has also acted negligently.[40] This is known as the doctrine of *contributory negligence.* Contributory negligence is defined as "an act or omission on the part of an employee, amounting to a want of ordinary care, which concurring or co-operating with a negligent act of an

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[37] *Reeder* v. *Crystal Carbonate Lime Co.*, 129 Mo. A. 107, 107 S. W. 1016.
[38] R., Sec. 479.
[39] *Chicago, etc., R. R. Co.* v. *May*, 108 Ill. 288.
[40] R., Sec. 525.

employer is the approximate cause or occasion of an injury complained of." [41]

> "The law does not impose on the employer any duty to take better care of his employee than the latter should take of himself." (Scott v. Western Union Telegraph Co., 198 N. C. 795, 153 S. E. 413)

The defense of contributory negligence is not available to the master when he has been guilty of willful or wanton negligence. Nor is it available when the negligence of the employee does not concur with the negligence of the employer, so as to be the approximate cause of the injury. In some states the doctrine of *last clear chance* has been applied in order to defeat the allegation of contributory negligence.[42]

Injuries to Third Persons. The master is liable to third persons for injuries resulting from acts of his servants which he expressly orders or directs.[43] He is also liable for the wrongful acts of his servants of which he has notice and to which he assents. For example, if the employer knows that his servant is depositing timber on the land of another and does not cause a removal, he impliedly assents thereto and is liable for the trespass.[44] Tortious acts of the servant, outside the scope of his employment, which would not ordinarily make the master liable, may be ratified so as to cast responsibility upon him. The master may also be liable for injuries to third persons which arise from his own negligence in not giving proper instructions or enforcing them, or in not selecting and retaining competent employees.

> A corporation was held liable when it ratified the act of its employee, who while delivering ice violently assaulted and injured a man. (Sullivan v. People's Ice Corporation, 92 Calif. A. 740, 268 P. 934)

In most cases, however, the liability of the master to third persons for injuries caused by his servants is based upon the doctrine of *respondeat superior* (let the master answer).

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[41] *Warren* v. *Jackson*, 204 Ill. A. 576.
[42] *Post*, Chapter XVI, p. 886.
[43] R., Sec. 215.
[44] *Elder* v. *Bemis*, 2 Metc. (Mass.) 599.

"Under the doctrine of respondeat superior, a master, however careful in the selection of his servants, is responsible to strangers for their negligence in the course of their employment." [45] The main difficulty in applying this doctrine is in determining what acts are within the scope of the servant's employment.[46] Such acts as are ordered are clearly within the scope of his work. Authorization of an act, however, is not necessary. "If a servant is guilty of a wrongful act when engaged in his master's business and while acting within the general scope of his authority, the master is liable although he did not authorize the particular task." [47] The employer is liable even though the act is a violation of his instructions, as long as it is committed in the prosecution of the business for which the servant is employed.[48] The same is true when the act is wanton and malicious.[49] To illustrate, the master is liable if an engineer maliciously blows the locomotive whistle for the purpose of frightening a team of horses which is approaching the crossing.[50]

> An employer was held not liable for the death of a trespasser by a concealed trap-gun which, without his knowledge, had been set up by his caretaker. (Ciamataro v. Adams, 275 Mass. 521, 176 N. E. 610)

The master is not liable, however, if the servant steps aside from the employment in which he is engaged. The relation of master and servant is suspended during such time. "Where there is not merely deviation, but a total departure from the course of the master's business, so that the servant may be said to be 'on a frolic of his own,' the master is no longer answerable for the servant's conduct." [51] Thus, if a delivery boy, while driving about the city for his own enjoy-

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[45] *Haluptzok* v. *Great Northern Ry. Co.*, 55 Minn. 446, 57 N. W. 144.

[46] The Restatement declares acts within the scope of the servant's employment to be acts of the kind that the employee was employed to perform, occurring substantially within the authorized time and space limits, and actuated, at least in part, by a purpose to serve the employer. Sec. 228-(1).

[47] *Denver, etc., R. R. Co.* v. *Conway*, 8 Colo. 1, 5 P. 142.

[48] R., Sec. 230.

[49] R., Sec. 231.

[50] *Culp* v. *Atchison, etc., R. R. Co.*, 17 Kans. 475.

[51] *Ritchie* v. *Waller*, 63 Conn. 155, 28 A. 29.

ment after making his deliveries, runs over a pedestrian, the master is not liable.[52]

Whether an act is outside the scope of employment is a question of fact to be decided in view of the circumstances of the particular case. The Restatement states that it depends "upon the extent of departure, whether or not an act, as performed in its setting of time and place, is so different in kind from that authorized, or has so little relation to the employment, that it is not within its scope." [53]

QUESTIONS

1. Garrett was employed by Chaney as a private chauffeur. While going after his employer, Garrett saw Marden, a man whom he disliked. Stopping the automobile, he hailed Marden, who thereupon started to run. Garrett gave chase but was unable to catch Marden. When Garrett realized this fact, he picked up a brick and threw it at Marden, striking him on the head. Was Marden entitled to bring an action for damages against Chaney?

2. The employees of Grennan customarily occupied a vacant room adjoining their place of work for the purpose of sharpening their tools. Koester, an employee, was injured by the floor in this room giving way. Was the master liable for damages?

3. Priest is injured while using machinery furnished by Porter, his employer. The former alleges that his employer is liable for damages because he did not supply his employees with the safest tools and appliances. Is his contention sound?

4. Trout was injured while using certain tools supplied by Fields, his employer. He proved that there were newer tools for doing the same work on the market at that time. Did this fact render the employer liable for the injury?

5. Keller, who is known to be a drunkard, is employed to drive an engine for the Motor Rail Company. While intoxicated, he runs past a stop light, thus causing an injury to Taggart, a fellow servant. The latter sues the company for damages. Is he entitled to judgment?

6. Einert is injured by a fellow servant. He sues his employer for damages, alleging that competent employees were not selected. Will proof that the fellow servant cannot speak the English language necessarily establish liability on the part of the employer?

7. Rennin employed eight workmen to do a particular piece of work. One of the employees was injured because another was temporarily

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[52] *Wills* v. *Belle Ewart Ice Company*, 12 Ont. L. 526.
[53] Sec. 228-(2).

called away from the task by Rennin. In an action for damages, it was admitted that all of the workmen were competent employees, and that eight constituted an adequate number. Was the employee entitled to judgment?

8. Partridge, who is employed to operate a lathe, suffers an injury by coming in contact with a revolving part of the machinery. He claims that the employer is liable because of failure to warn him of the danger. Is his contention sound?

9. Heineman, who was employed by Strickfadden, was injured by a defective machine. He had discovered the defect before the injury occurred but had continued his work without reporting the matter. Was the employer liable?

10. Kline discovered a defect in a machine furnished to him by his employer. When he reported the defect, he was told by his employer either to quit or to continue to work. Shortly after continuing with his work, Kline was injured by the defective machine. Was the employer liable?

11. On Monday morning, Strodel reported a defective machine and the employer promised to repair it on the next day. What was the liability, if any, of the master for an injury to Strodel, caused by the defect, occurring on Monday afternoon? on the following Wednesday morning?

12. Soyden, who was injured by a fellow servant, sued the employer for damages. The defense of the latter was the fellow-servant doctrine. Soyden proved that the injury was caused by a failure to employ a sufficient number of competent employees. Was Soyden entitled to judgment?

13. In the trial of an action for damages brought by an employee against his employer, the latter's liability depended on whether Lawhead, who caused the injury, was a fellow servant of the plaintiff. How would you determine this question?

14. Lautz places Sanford, an employee, in charge of tools and appliances. The latter's failure to supply reasonably safe machinery results in an injury to another employee. Is Lautz liable for damages?

15. A foreman who was in charge of a crew of workmen frequently assisted the group in moving heavy objects. While he was assisting them in moving a heavy rail, one of the workmen was injured because of the foreman's negligence. Was the employer liable for the injury?

16. Tascher, who is employed by Hoerner, is injured by a crack in a circular saw which he negligently attempts to slow down by pressing his hand against the side of the revolving disc. Is Hoerner liable for damages?

17. Gillheart is employed by Corsage to drive a delivery truck. The former is expressly instructed to drive slowly and carefully. Gillheart, while making some deliveries, drives past a stop light and runs into Keag's machine without fault of the latter. Is Keag entitled to bring an action for damages against Corsage?

Part III—Rights and Duties of Servant

Services. The servant is under a duty to perform or hold himself in readiness to perform such services as may be required by the contract of employment. "In the absence of any express provision to the contrary, all that the employee engages to do is to hold his time and services subject to the disposal of the employer, and to perform such duties, within the scope of his employment, as may from time to time be assigned to him. If the employee holds himself in readiness and complies with his employer's directions in such employment, he has discharged his obligation, and the law will not require him to forfeit his right to the compensation agreed upon because the employer has seen fit to withhold directions from him and has thus kept him in idleness." [1]

> When an employee sued his employer for breach of contract, "he was not required to tender performance under a contract the existence of which defendant denied." (Baldwin v. Transitone Automobile Radio Corp., 314 Pa. 10, 169 A. 754)

The employee impliedly agrees to serve his employer honestly and faithfully. He also agrees to serve him exclusively. The employee may, however, do other work if the time and nature of the employment are not inconsistent with his duties to the employer. For example, one who engages to give his whole time and services to another may do other work after business hours or on holidays.[2] In the absence of an express contract, the servant impliedly purports that he will perform his duties in a workmanlike manner. This means that he will exercise due care and ordinary diligence in view of the nature of the work. When skill is required, the employee must possess only ordinary ability. "In cases of this sort he must be understood to have engaged to use a degree of diligence and attention and skill adequate to the performance of his undertaking. Ordinary skill means that degree which men engaged in that particular art usually employ, not that which belongs to only a few men of extraordinary endowments and capacities." [3]

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[1] *Berg* v. *Carroll*, 16 Daly 73, 9 N. Y. S. 509.
[2] *Hermann* v. *Littlefield*, 109 Calif. 430, 42 P. 443.
[3] *Baltimore Baseball Club Co.* v. *Pickett*, 78 Md. 375, 28 A. 279.

Inventions. The employee may expressly agree that his inventions made during his employment will be the property of the employer. Such contracts must be clear and specific as the courts are inclined to a rule of strict construction as against the employer. He may also agree to assign inventions made after the term of employment. For example, a provision in the contract of employment may stipulate for an assignment of all inventions made by the employee "during a period of one year following the termination of the employment." [4]

> An agreement by a mechanical engineer to assign inventions made during time employed by a company engaged in the manufacture of musical instruments was held not unreasonable and was specifically enforced. (Conway v. White, 9 F. [2d] 863)

In many cases, because of the nature of the work, courts hold that the inventions equitably belong to the employer, on the ground either that there is an estoppel due to the trust relation or that there is an implied agreement to make an assignment. This is particularly true when the employee is especially hired to secure certain results from experimental work. "If one is employed to devise or perfect an instrument, or a means for accomplishing a prescribed result, he cannot, after successfully accomplishing the work for which he was employed, plead title thereto as against the employer. That which he has been employed and paid to accomplish becomes, when accomplished, the property of his employer." [5]

> "The government as an employer has no greater right to inventions made by its employees than other employers." (United States v. Dubilier Condenser Corp., 49 F. [2d] 306)

On the other hand, in the absence of an express or implied agreement to the contrary, the inventions of an employee belong to him, even though he has used the time and property of the employer in creating them. Thus one court has stated: "The mere fact, outside of any specific contract, that the appellant was in the employment of appellee and received

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[4] *Nat'l Cash Reg. Co.* v. *Remington Arms Co.*, 122 Misc. Rep. 234, 202 N. Y. S. 691.

[5] *Solomons* v. *U. S.*, 137 U. S. 342, 34 L. Ed. 667.

wages, and even used the materials of appellee in the manufacture of his models, and even received assistance in making models, from the latter's employer, would not give it (the employer) the property in the invention to the exclusion of the former. An invention is the product of the mind, and the making of models and experiments are only mechanical operations, and mere labor performed for appellant under his direction, for which he would be liable to be charged, or the time lost deducted from his wages or time. As between the employer and employee, the right to the invention belongs to the one who conceived the idea, and followed it out to practical invention." [6]

Trade Secrets. An employee is frequently given confidential trade secrets by his employer. He is under a duty not to disclose such knowledge. If he violates this obligation, the employer may enjoin the use of such information. For example, where an employee gives a competitor a book containing a confidential key to prices in code, the master can enjoin the competitor from using it and compel the return of the same.[7]

It is immaterial that the contract of employment did not stipulate against such disclosures. "If one person has a trade secret which is valuable to him, and another person enters into confidential employment with him in and about the business which demands the use of that secret, he cannot utilize his secret knowledge to the disadvantage of his employer. If he does so, he robs his employer. That is the contract relationship between them, and it makes no difference whether it is expressed in writing. If not expressed, it will be implied." [8]

After the termination of employment, the employee is often entitled to use in his new employment knowledge which he acquired during former employment. The use of such knowledge, "if it involves no breach of confidence, is not unlawful, for equity has no power to compel a man who changes employers to clean the slate of his memory." [9] The employee

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[6] *Dice* v. *Joliet Mfg. Co.*, 11 Ill. A. 109.
[7] *Simmons Hardware Co.* v. *Waibel*, 1 S. Dak. 488, 47 N. W. 814.
[8] *H. B. Wiggins Sons and Co.* v. *Cott-A-Lap Co.*, 169 F. 150.
[9] *Peerless Pattern Co.* v. *Pict. Rev. Co.*, 147 App. Div. 715, 132 N. Y. S. 37.

is under no duty to refrain from divulging general information of the particular business in which he is employed. Nor is he under a duty not to divulge the information of the particular business when the relation between employer and employee is not considered confidential.

Compensation. The right of an employee to compensation arises out of some contract, express or implied. The right to compensation is implied when services are requested of one in his regular work or when other circumstances indicate that the services were not to be rendered gratuitously. When there is an express agreement as to compensation, its provisons will govern. Hence the servant's right to remuneration may possibly depend upon one of several circumstances. At common law the employee had no lien on the property of the employer for his wages in the absence of a special contract.

> Statutory liens on employers' property are often only for "laborers," but some statutes specify "all employees." (Robertson v. Wise, 153 S. C. 459, 151 S. E. 87)

Amount. The amount of compensation, when fixed by contract, is limited to the sum named or to the sum computed at the rate stipulated. When the amount of remuneration is not fixed by agreement, the employee is entitled to recover the reasonable value of his services. In such a case, reasonable value is generally considered to be wages paid for that form of labor at that particular time and place. It may be shown, however, that, although employed to do service of one sort, the employee is entitled, through the actual service performed, to a higher wage than one usually receives for performing the class of service for which he was hired. Thus, the fact that a person engaged as bookkeeper is given executive duties must be considered in determining what is reasonable compensation.[10]

When Discharged. As a general rule, the employer is liable for services actually rendered, although the employee is discharged for cause. A few states deny recovery on the

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[10] *Crusoe* v. *Clark*, 127 Calif. 341, 59 P. 700.

ground that it would encourage the breach of contracts. The injustice of allowing the employer to retain the benefits of the employee's work has led these courts to make an exception in cases in which wages are payable in installments at stated intervals. "In such cases, the rule in some jurisdictions is that a servant who has abandoned his contract or has been discharged for misconduct, is entitled to be paid any installment of salary or wages which had accrued when his employment ceased." [11] All courts agree that the employee is not entitled to wages earned during a fractional part of a period at the end of which wages would be due, unless there is an agreement to the contrary.

When Work Is Abandoned. When the employee abandons the service for good cause, he is entitled to wages for work actually performed. On the other hand, if he abandons the service without cause, he cannot recover wages under the contract, unless it provides for periodical payments, some of which are due. Thus, if the contract of employment calls for the weekly payment of wages, a servant who quits without cause can recover all wages due for each full week of service.[12] In most states an employee who quits without cause is not allowed to bring an action against the employer for the value of his services. Some states, however, permit such an action, although they limit recovery to not more than the contract price after the damages suffered by the employer are deducted.

QUESTIONS

1. Jones was employed by the Linde Refrigeration Company, which was engaged in the business of storing meats and other commodities. During his spare time he worked for a corporation engaged in marketing cold storage machinery. In an action brought by Jones against the Linde Refrigeration Company, it was contended that Jones had been guilty of a breach of duty owed to his employer. Do you agree?

2. Lintner employs Galen as a machinist. Later Lintner complains of Galen's work on the ground that it is not performed with the skill exercised by Bishop, who is reputed to be the best machinist in the country. Is Lintner's complaint justified?

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[11] *Lindner* v. *Cape Brewery and Ice Co.*, 131 Mo. A. 680, 111 S. W. 600.

[12] *Seaburn* v. *Zachmann*, 99 App. Div. 218, 90 N. Y. S. 1005.

3. Stanners is employed by the Lone Eagle Company to devise an automatic parachute by which a disabled airplane can be safely landed. After completing the device, Stanners claims the invention. Is he entitled to it?

4. Berlinger was employed by a company to act as a salesman in a dry goods store. At odd times during the day he would slip into a back room and experiment with materials belonging to his employer. Under these circumstances Berlinger invented a new type of wing for an airplane. Was Berlinger or the employer entitled to the invention?

5. Gadbois is employed by a photographer to mix the latter's solutions for the development of pictures. The employer has a peculiar formula for these solutions, which Gadbois discloses to a competitor for a sum of five hundred dollars. May the latter be enjoined from using the information?

6. Hornell, while employed as a plumber by Ward, acquires information which is known generally in the plumbing trade. Is Hornell under a duty to refrain from divulging this information?

7. Mathews was employed by the S. N. Wilcox Lumbering Company. His wages were not paid for a certain period of time. In an action between Mathews and the lumbering company, Mathews contended that he had a lien on the goods of the company for his unpaid wages. Was his contention sound?

8. Givens, a contractor, employed Bert Nelson as a laborer to dig ditches on a project in Kansas City, Missouri. At the time of the employment agreement neither party mentioned the subject of wages to be paid. Subsequently Nelson demanded the wages that were being paid for common labor in San Francisco, California. Was he justified in so doing?

9. Saling is employed by Boagin as a tool sharpener for a period of three years. He abandons this service for a good cause at the end of two years. Boagin maintains that Saling can sue for breach of contract but is not entitled to bring an action for wages for services actually performed. Is the former's contention sound?

10. Given employs Culison to work in a mill for one year. The terms of the agreement provide that the latter's salary shall be paid in twelve installments on the last day of each month. Culison is discharged for good cause at the end of the third week of the fifth month. How much salary, if any, is Culison entitled to recover from Given?

Part IV—Terminating the Relation

Methods. A contract of employment establishing the relation of master and servant may, in general, be terminated in the same manner as contracts of any other kind. It may come to an end at the expiration of the term specified, or at the will of either the master or servant when the term of employment is indefinite. Death of the servant or his inability to perform his duties will terminate the relation. The same rule is applied upon the death of the master, except when the contract of employment is of such nature that it can be carried out by the personal representative. The contract of employment may also, of course, be terminated by mutual agreement at any time.

> When a theatrical performer accepted and performed under a new contract with his employer, the earlier contract was extinguished by mutual assent. (Billclair v. Wirth & Hamid, 134 Misc. Rep. 801, 236 N. Y. S. 306)

One form of the last method is a stipulation in the original agreement which gives one or either of the parties the right to terminate the relation upon the happening of a certain contingency. For example, it may be agreed that the employer is entitled to terminate the relation on the payment of a certain sum, or that the employment may be terminated on the burning of a certain building.[1] It is frequently stipulated that the employer may bring an end to the relation if he is not satisfied with the services of the employee. In such cases the employer is generally considered the sole judge of his reason, but he must act in good faith. Thus one court stated: "The only question to be determined was whether or not the defendant was in fact dissatisfied and discharged the plaintiff for that reason. If his dissatisfaction was real, and not assumed merely to rid himself of his employee, it was of no consequence whether or not the jury thought that he ought to have been satisfied." [2] When the right to terminate the contract is dependent upon the giving of a stipulated notice,

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[1] *Edwards* v. *Block*, 73 Ga. 450.
[2] *Ginsberg* v. *Friedman*, 146 App. Div. 779, 131 N. Y. S. 517.

the parties must comply with such stipulation. The party giving notice may waive effect of notice, in which case he must renew the notice in order to terminate the relation rightfully. The right to notice may also be waived by one entitled to it.

Justifiable Discharge. One of the two methods of terminating a contract of employment in which we are most interested is that of a discharge. A master may dispense with the services of his servant rightfully or wrongfully. The discharge of a servant before the end of the period specified in the terms of the employment contract may be justified on one of several grounds.

Nonperformance. The master is justified in discharging the servant who refuses to carry out his part of the contract. Thus, if the employee refuses to work on the days specified, he may be rightfully discharged.[3]

> "Suggestions and even objections as to manner of enacting the various scenes, when made in good faith," did not constitute a refusal to perform contract by a motion picture actress. (Goudal v. Cecil V. De Mille Pictures Corp., 118 Calif. A. 407, 5 P. [2d] 432)

Fraud. The employer may rightfully discharge the employee when the relation has been established by means of fraud on the latter's part. To illustrate, when the servant falsely represents certain facts in order to secure the contract of employment, he cannot complain of his discharge on that ground.[4]

Disobedience. In some states the employer is entitled to discharge the employee for willful disobedience of any proper order. In other states, courts hold that such disobedience must relate to orders which are reasonably expected to be followed. Disobedience as a ground for discharge involves a question of insubordination; hence in either jurisdiction there must be an act denoting a perverse disposi-

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[3] *Nelson* v. *Pyramid Harbor Packing Co.*, 4 Wash. 689, 30 P. 1096.
[4] *Newman* v. *Reagan*, 63 Ga. 755.

tion. Thus a violation of an unknown rule is not a valid ground for dismissal.[5]

Disloyalty. The discharge of the servant is justified where he engages in activities which are inconsistent with the interests of his master. By way of illustration, the servant may be discharged without further cause when he secretly engages in competition with the master.[6]

Incompetency. A servant may be dismissed when he displays an inability to perform, in a reasonably skillful manner, the duties for which he is employed. For example, the services of an accountant whose reports show errors and discrepancies may be dispensed with on this ground.[7]

Justifiable Abandonment. The other way of terminating the relation of master and servant, which is of particular interest to us here, is that of abandonment. The employee cannot, as a general rule, be compelled to perform his contract of employment. Hence he may at any time end the relation by a refusal to perform the services for which he was engaged. His refusal to carry out his part of the contract may be wrong or right, depending upon the ground for leaving his employment. The servant is justified in abandoning his employment under any one of several circumstances, such as nonpayment of wages, assault, wrongful requirements, or injurious conditions, unless the right is waived by continued service.

> When employment contract calls for performance to the satisfaction of the employer, the latter is sole judge of his satisfaction, provided he acts in good faith. (Coats v. General Motors Corp., 3 Calif. A. [2d] 340, 39 P. [2d] 838)

Nonpayment of Wages. When the employer refuses or neglects to pay the wages fixed by the contract of employment, the employee is justified in abandoning the service. Anticipation of nonpayment of wages, however, is not suffi-

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[5] *Lehigh Valley R. R. Co.* v. *Snyder*, 56 N. J. L. 326, 28 A. 376.
[6] *Mattingly* v. *Manhattan Oil Co.*, 96 Nebr. 742, 148 N. W. 938.
[7] *Griffin* v. *Haynes*, 24 La. Ann. 480.

cient. For example, the servant is not entitled to leave the service because he fears that the master will be unable to pay his wages.[8]

Wrongful Assault. The servant is justified in leaving his employment when he is wrongfully assaulted by his master. Mere disagreement with the employer, however, resulting in rude remarks or harsh language, is generally not sufficient. Whether the language used in the remarks of the master gives cause to quit depends largely upon the service and the parties to the relation. To illustrate, it has been held that where the employee, with his wife and child, lived with the employer, the nature of the service was such that harsh and profane language on the part of the employer justified an abandonment on the part of the servant.[9]

Services Not Contemplated. When services which were not contemplated by the agreement are required of the employee, he is entitled to withdraw from the employment. So long, however, as the work is within the nature of the services for which the servant is engaged, he cannot complain of its severity or unpleasantness. It must also be clear that the employer requires the particular work. Thus, when the master does not insist upon labor which has been requested, there is no cause for abandonment.[10]

Injurious Conditions. Whenever the conditions of the employment, because of the negligence or acts of the master, are such as are likely to result in harm to the servant's reputation, morals, health, or safety, the latter is justified in leaving the service. To illustrate, the requiring of illegal or immoral services is sufficient for abandonment, or the mere fact that the employee is exposed to immoral influences will justify abandonment.[11]

Remedies. An employee who has been wrongfully discharged may proceed against the employer in one of the

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[8] *Kansas City Amer. Assoc. Baseball Club* v. *Pickett*, 8 Pa. Co. 232.
[9] *Murphy* v. *Williamson*, 180 Iowa 291, 163 N. W. 211.
[10] *Koplitz* v. *Powell*, 56 Wis. 671, 14 N. W. 831.
[11] *Warner* v. *Smith*, 8 Conn. 14.

following actions: (1) for wages, (2) for breach of contract, and (3) for value of his services.

Action for Wages. The employee may bring an action for all wages due at the time of the wrongful discharge. There is a conflict in decisions as to whether an action can be brought for wages for the unexpired term of employment. Some states, following the early English doctrine of constructive service which has since been repudiated, hold that such action may be maintained. Thus, when wages are paid at stated intervals, the servant may in these states sue for the amount of each installment at such time as it becomes due under the terms of the contract.[12] Other states hold that an action for wages can be brought only for past services and that the servant must resort to breach of contract for claims in respect to the unexpired term.

> A statute giving an employee wrongfully discharged a right of action to recover unearned wages "is a penal statute." (Wells v. Sherrill Hardwood Lumber Co., 151 La. 1081, 92 S. 706)

Action for Breach of Contract. The employee may bring an action for breach of a contract at the time of the wrongful discharge, at the expiration of the term, or at any intermediate time. Whether the servant is suing for wages for the unexpired time or for damages, he is under a duty to seek similar employment in that community. For example, the amount recoverable may be reduced by showing that the servant received or might have received wages for doing similar work.[13]

Action for Value of Services. When discharged wrongfully after having performed services under the contract, the servant may treat the contract as rescinded and recover the value of his services. In such a case he is suing on the basis of no contract, and he cannot later bring an action for breach of contract.

The employer can bring an action for breach of contract against the employee who abandons his employment without

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[12] *Fowler* v. *Armans*, 24 Ala. 194.
[13] *Spahn* v. *Williams*, 17 Del. 125, 39 A. 787.

cause. This right is of little value as the employee, generally speaking, is not able to pay damages. The employee's breach of contract is sometimes induced by a third person, in which case the latter is liable to the employer in an action of tort.[14] This right of action is usually more valuable to the employer than his right to damages against the employee for breach of contract, as the person inducing the breach is ordinarily more likely to be able to pay damages.

QUESTIONS

1. A contract of employment gives the employer the right to terminate the relation by giving ten days' notice. The employee is given the required notice of the employer's intention to terminate the relation, but he is allowed to continue his services. Two months later the employee is discharged without notice. The employee maintains that the relation had not been properly terminated. Is his contention sound?

2. Tobin contracts for the service of Rayborn, stipulating in the agreement that he is entitled to terminate the relation if not satisfied with the latter's work. Rayborn is discharged by Tobin, who is honestly dissatisfied with his services. The former brings an action for damages, alleging that his services would satisfy a reasonable person. Is he entitled to judgment?

3. The Fair Company, a corporation operating a large department store, employed Miller for a period of one year to wrap bundles. After working for a month at his task, Miller refused to wrap bundles but expressed a willingness to do any other tasks that might be assigned to him. He was discharged and subsequently brought an action to recover damages from The Fair Company. Was he entitled to judgment?

4. An employer personally gives notice individually to his employees that they are not to smoke in the work rooms of the factory. He fails to tell one employee, Keeg, of this rule. Later Keeg is discovered by the employer in the act of smoking in one of the work rooms. Is the employer justified in discharging Keeg?

5. Gottlieb is employed by Conger as a patternmaker for a period of two years. The molding department finds that it is impossible to use the patterns made by Gottlieb because he habitually makes them so that they cannot be withdrawn from the mold. At the end of one year Conger discharges Gottlieb. Is the latter entitled to sue for breach of contract?

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[14] *Post*, p. 890.

6. Lowenthal enters into a contract of employment with a storage company. Hearing that the company is in financial difficulties, he abandons its service under the belief that it will not be able to pay his wages. Is his action justified?

7. The Federal Heights Realty Company employed Ellis to remove cinders from several apartment buildings. Before the end of the period of employment Ellis abandoned the service because he found the work to be unpleasant. He contended that his action was justified. Do you agree with this contention?

8. An employee who is hired to operate a steam shovel is requested by his employer to operate an elevator. Is an abandonment of the service by the employee justified under these circumstances?

9. Lombecker was employed by Macorpin to paint lamp shades. One day, because his work did not please Macorpin, the latter said to him, "You are the dumbest man on the job." Lombecker thereupon abandoned his employment. Was he justified in so doing?

10. Brumagen was employed as an engineer by the Silver Smelting Company for a period of five years. The terms of the agreement provided that Brumagen's wages would be paid on the first day of each month. At the end of two years Brumagen was wrongfully discharged. Was he entitled to bring an action for wages?

11. An employee who was wrongfully discharged elected to rescind the contract of employment and sued for the value of his wages. Later he brought an action for breach of contract. Was he entitled to judgment?

12. Fulrath has agreed to perform services for Arrandale during a period of three years. Wickersham maliciously induces the former to abandon his employment. What are Arrandale's rights, if any, against Fulrath? against Wickersham?

Part V—Modern Labor Legislation

Necessity for Legislation. The common-law rules, in respect to the rights and duties of the employer and the employee, are unfair and unjust in many ways. It is stated that the servant has impliedly assented to the assumption of the ordinary risks of an industry. It is also stated that the servant has been paid a higher wage in consideration for the assumption of such risks. Both theories proceed on the basis that the employee can pick and choose, or reject, work of a certain character, which in fact may not be true. "The employer and the employed, in theory, deal upon equal terms; but, practically, that is not always the case. The artisan or workman may be driven by need, or he may be ignorant or of improvident character." [1]

Irrespective of the merits of the theories behind them, these rules may have been adequate for a day of simple industries in connection with which they developed. Workers in those days labored singly or in small groups. They were well acquainted with, if not related to, their fellow servants; consequently there was general consideration for the safety of others. In addition, they operated comparatively simple machines. For these reasons, the work was not ordinarily hazardous, and accidents were more or less infrequent.

Industrial conditions, however, have changed radically. Modern business with its huge enterprises presents conditions which are quite different from those of early days. Many persons work to further a common enterprise under one management. They are unknown to each other, while at the same time they are more dependent upon each other. They operate powerful, complicated, and dangerous machines which take a periodical toll in human injuries and life, irrespective of the care exercised. Consequently, the legal principles governing the liability of the master, developed by the common law, have proved to be inadequate to cope with modern business conditions.

To adjust the law to modern conditions, and thus to eliminate much unfairness, statutes of various types have been en-

[1] *Johnston* v. *Fargo*, 184 N. Y. 379, 77 N. E. 388.

acted. The first were of the nature merely to prevent injuries, imposing greater duties upon the master to provide safety devices or better working conditions. Later legislation has proceeded on the theory that injuries occasioned by a business must be assumed by it in the first instance and passed on to the consumer. It is impossible to consider here all of the legislation of this kind, but a few of the outstanding statutes will be noted briefly to indicate the trend of legislation.

Modern labor legislation is also the result of two other factors. New problems in connection with the relation of employer and employee are not adequately solved by means of common-law rules and principles. The same is true of old problems that have only recently gained social recognition. Some of the legislation in connection with these problems will hereinafter be considered.

Employee's Lien or Preference. An employee at common law was given no lien for his wages, except when he was also a bailee.[2] Most states today, however, have enacted legislation which protects an employee's claim for compensation either by a lien or preference over other creditors. "Such statutes are said to be founded upon the broadest equity, and are for the protection of a peculiarly helpless and meritorious class of creditors, whose claims are usually small and who are suddenly compelled to shift for themselves by the failure of their employers. If the statute does not, in terms, create a specific lien upon the property of the employer, it accomplishes the same result by securing to the employee priority of payment over all other claimants out of the proceeds of the property of the employer." [3]

> "'In the absence of a contract or a statute giving him a lien, a servant has no lien for wages.' (Cairns v. Louisville & Nashville R. Co., 248 Ky. 84, 58 S. W. [2d] 248)

These statutes vary widely in their terms; consequently they cannot be discussed here in detail. They are usually called Laborers' or Mechanics' Lien Laws. Only employees

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[2] *Post*, Chapter VII, pp. 462 and 472.
[3] *Small* v. *Hammes*. 56 Ind. 556, 60 N. E. 342.

within the class designated may claim under such statutes. For example, it was held that a foreman cannot claim under a statutory provision giving the privilege to managers, mechanics, or laborers.[4] It is generally held that the statutes protect only claims based upon work personally rendered. Thus compensation for the use of materials, machinery, or teams is not protected.[5] It sometimes happens that the statutes limit the privilege to the workmen of a particular business, in which case the employee in order to fix a lien must not only come within the class enumerated, but must also be engaged in the specified service. Another important point to be noted in the various statutes is the duration of the lien. To illustrate, the privilege granted to the employee may be limited to a certain period of time specified in the provisions of the statute, as ten days after he ceases to work.[6]

Compensation Laws. Most states, following the initiative of New York in 1910, have adopted some form of workmen's compensation laws. These statutes provided various schemes whereby relief is given to specified workmen or their families in the event of injuries or death arising out of industrial accidents. The statutes also vary as to the employments covered. Most of them provide for prompt and definite, but only partial, relief. They are not strictly industrial insurance laws, although they contain some modifications thereof.

> "The compensation provided for in the act is in no sense to be considered as damages for the injured employee or to his dependents in case death intervenes, but as compensation for the injuries received." (Wirta v. North Butte Mining Co., 64 Mont. 279, 210 P. 332)

The general features of the various workmen's compensation acts are in the following terms:

(1) The employer is placed under a duty to make partial compensation for disability or death resulting from certain accidental injuries.

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[4] *Swain* v. *Kirkpatrick Lumber Co.*, 143 La. 30, 78 S. 140.
[5] *Hilley* v. *Lunsford*, 29 Ga. A. 398, 115 S. E. 667.
[6] *Blackburn* v. *Bell*, 125 Calif. 171, 57 P. 775.

(2) Compensable injuries must arise out of and in the course of the employment.

(3) The liability is imposed irrespective of the negligence of the employer or the fault of the employee, except when such injury or death is the result of the latter's willful intention or intoxication while on duty.

(4) The amount of compensation for disability varies in accordance with a prescribed scale based upon the loss of earning power.

(5) The amount of compensation for death is determined in view of the nature and number of dependents.

Provisions are made for the establishment of commissions to administer the laws, and the determination of the validity of the claims. In order to assure the employee that compensation will be paid, various schemes have been adopted, some of which give optional plans. For example, by the terms of one statute, "each employer is required to secure compensation to his employees in one of the following ways: (a) by insuring and keeping insured the payment of such compensation in the state fund; or (b) through any stock corporation or mutual association authorized to transact the business of workmen's compensation insurance in the state; or (c) 'by furnishing satisfactory proof to the commission of his ability to pay such compensation for himself, in which case the commission may, in its discretion, require the deposit with the commission of securities of the kind prescribed in section thirteen of the insurance law, in an amount to be determined by the commission, to secure his ability to pay the compensation provided in this chapter.'" [7]

Federal Legislation. The trend of Federal legislation has been toward the abolishment or modification of the common-law rules in respect to the liability of the employer in employments over which Congress has control, and toward the imposition of greater duties promotive of safety. It is impossible to mention here all of the acts bearing on this subject or to discuss them in detail. A few of the Federal statutes will be noted here for the purpose of indicating their tendency.

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[7] *N. Y. Central R. R. Co.* v. *White*, 243 U. S. 188, 61 L. Ed. 667.

Some of the recent statutes will be discussed more fully in the sections following, because of their far-reaching effect and because of the general interest in them.

Safety Appliance Act.[8] This act of Congress declares it to be unlawful for any common carrier engaged in interstate commerce to use engines or cars without certain specified safety appliances and equipment. A fine is provided for each violation. An employee whose injury is due to a violation of this act on the part of the carrier "shall not be deemed thereby to have assumed the risk thereby occasioned, although continuing in the employment of such carrier after the unlawful use of such locomotive, car, or train had been brought to his knowledge."

> When car handholds complied with the Safety Appliance Act, and a wire was placed thereon by some unknown person, the liability of the carrier for injury to a brakeman depended upon common-law rules. (Chicago, R. I. & P. Ry. Co. v. Benson, 352 Ill. 195, 185 N. E. 244)

Hours of Service Act.[9] Congress provided in this act that no employee of a common carrier engaged in moving trains should work longer than sixteen consecutive hours, or within ten hours thereafter, or within eight hours after sixteen hours of labor within any twenty-four hours. Employees whose duties are to transmit orders by telephone or telegraph for moving trains are limited to nine and thirteen hours according to the specified circumstances. In case of emergency the hours of work may be slightly extended.

Employers' Liability Act.[10] This act contains provisions in respect to the liability of the common carrier in case of injury or death while engaged in interstate commerce. It declares void any contract, rule, or device employed to exempt the carrier from such liability. The act, however, does not make the carrier an insurer of the employee's safety. On the other hand, it does materially change the doctrines of the common law in respect to the risks assumed by the servant. One pro-

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[8] *U. S. Code, 1925*, Title 45, ch. 1, p. 1437.
[9] *U. S. Code, 1925*, Title 45, ch. 3, p. 1443.
[10] *U. S. Code, 1925*, Title 45, ch. 2, p. 1442.

vision provides for the survival of the right of action in favor of personal representatives.

National Labor Relations Act.[11] On July 3, 1935, Congress enacted a statute to eliminate certain obstructions to commerce (1) by encouraging the practice and procedure of collective bargaining and (2) by protecting the right of workers to full freedom of association, self-organization, and designation of representatives for the purpose of negotiating the terms and the conditions of their employment. This act was changed considerably by an amendment, known as the Labor Management Relations Act of 1947, commonly known as the Taft-Hartley Act. The amendment differs from the original act in that it is predicated upon the assumption that industrial strife is due jointly to certain activities of some employers and certain practices of some labor organizations.

> "It is the prevention of strikes, the impact of which upon interstate commerce when and if they occur will directly and immediately burden or obstruct such commerce, that furnishes the ground for the exercise of the Congressional power." (Clover Fork Coal Co. v. National Labor Relations Bd., 97 F. [2d] 331)

National Labor Relations Board. This Board consists of five members who are appointed by the President with the advice and consent of the Senate. A General Counsel of the Board, appointed in like manner, has independent authority over the prosecution of complaint cases. The Board conducts and determines unfair labor practice complaints. It may seek injunctions against all unfair labor practices, and it is required to do so against certain strikes and boycotts. It is required to take votes on the question of employees authorizing a union-shop contract, on the question of professional employees or craftsmen creating a separate bargaining unit, and, in case of national strikes, on the question of the employees' accepting the last offer of the employer.

Rights of Employees. The amended act expressly specifies that employees shall have the right (1) to self-organization,

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[11] 29 U. S. Code Ann., 141; Cumulative Pamphlet, July, 1947.

(2) to form, join, or assist labor organizations, (3) to bargain collectively through representatives of their own choosing, (4) to engage in concerted activities (with some limitations) for the purpose of collective bargaining or other mutual aid or protection, and (5) to refrain from all or any of such activities, except as to payment of membership initiation fees and dues when there is a valid union-shop agreement. The act also guarantees generally the right of individual employees to refuse to work. It expressly declares, however, that it shall be unlawful for employees of the United States Government or any agency thereof to participate in a strike. For a violation of this provision the employee shall be discharged, shall forfeit his civil service status, if any, and shall not be eligible for reemployment for a period of three years.

> The National Labor Relations Act does not give an employee the right to violate reasonable rules of his employer. (Midland Steel Products Co. v. National Labor Relations Bd., 113 F. [2d] 800)

Employer Unfair Labor Practices. The amended act declares that it shall be an unfair labor practice for an employer: (1) to interfere with, restrain, or coerce employees in the exercise of the rights expressly granted to employees; (2) to dominate or interfere with the formation or administration of any labor organization or to contribute financial or other support to it; (3) to encourage or discourage membership in any labor organization by discrimination in regard to hire or tenure of employment or any term or condition of employment; (4) to discharge or otherwise discriminate against an employee because he has filed charges or given testimony under this act; or (5) to refuse to bargain collectively with the representatives of his employees.

Rights of Employers. The amended act gives to the employer the right (1) to petition for an investigation of the representation of his employees, (2) to refuse to recognize or bargain with unions composed of supervisors, (3) to file charges of unfair labor practices against unions, and (4) to sue unions for damages arising out of violations of collective contracts or resulting from certain strikes and secondary boycotts. The act also limits to some extent the liability of

an employer with respect to statements on labor matters and with respect to discharges under union-security contracts.

> The authority of the Board in determining a collective bargaining unit "is not an absolute one—it must be exercised within the permissible limits of administrative discretion." (National Labor Relations Board v. Jones & Laughlin St. Corp., 146 F. [2d] 718)

Union Unfair Labor Practices. The amended act declares that it shall be an unfair labor practice for a labor organization or its agents: (1) to restrain or coerce employees in the exercise of the rights expressly granted to employees; (2) to restrain or coerce an employer in the selection of his representatives for purposes of collective bargaining; (3) to cause or to attempt to cause an employer to discriminate against an employee for any reason other than, when there is a union-shop agreement, the failure to pay uniform membership initiation fees and dues; (4) to refuse to bargain collectively with an employer; (5) for certain purposes, to engage in strikes and secondary boycotts; (6) to require of employees excessive or discriminatory initiation fees; or (7) to exact or attempt to exact payment or other remuneration for services which are not performed or not to be performed.

Other Important Provisions. The amended act abolishes closed-shop agreements, but it permits union-shop agreements when authorized by a majority of the employees in the unit affected. It requires labor organizations to file annually with the Secretary of Labor a report containing statements with reference to finances and other matters. A disavowal of membership in the Communist Party or affiliation therewith by union officers is also required.

The amended act establishes a Federal Mediation and Conciliation Service and an advisory National Labor-Management Panel, in order to encourage peaceful settlements of labor disputes. It also prescribes procedures for the postponement and peaceful settlement of strikes endangering national health or safety. Another provision creates a congressional committee, known as the Joint Committee on Labor-Management Relations, to study and report on basic problems affecting friendly labor relations and productivity.

Fair Labor Standards Act of 1938.[12] This act of Congress is commonly known as the Wage and Hour Act. It provides that, beginning on October 24, 1938, workers producing goods moving in interstate commerce must be paid a minimum wage of 25 cents an hour, and time and a half for hours worked in excess of 44 hours weekly. The minimum wage is set at 30 cents an hour for 42 hours weekly beginning one year later, and at 40 cents an hour for 40 hours weekly beginning six years later. The bill also provides that time and one half payments start after the standards of 44, 42, and 40 hours respectively.

> "The rule prescribed by the authorities in arriving at the hourly rate is to divide the weekly fixed salary by the number of hours actually worked." (Green v. Riss & Co., 45 F. Supp. 648)

Neither the wage nor the hour provisions apply to: (1) agricultural workers, seamen, or employees of airline, streetcar, motorbus, interurban railway, and certain publishing companies; (2) persons acting in executive, administrative, professional, or local retailing capacities, or as outside salesmen; (3) employees in the fishing industry; (4) employees in the area of production handling or preparing agricultural or horticultural products, or making dairy products. The hour provision does not apply to employees of carriers regulated by the Interstate Commerce Commission and to employees engaged in the initial processing of products in the dairy, cotton, sugar beet, and maple sirup businesses. The hour provision applies only partially to employees in seasonal industries and employees working under collective bargaining agreements that provide for a maximum of 1,000 hours' work in 26 weeks or 2,000 hours' work in 52 weeks.

The act prohibits the employment of children under the age of fourteen years. It permits the employment of children between the ages of fourteen and sixteen years in all industries, except mining and manufacturing, under certain prescribed conditions.

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[12] *Statutes at Large*, Vol. 52, Chapter 676.

Federal Social Security Act.[13] On August 14, 1935, Congress enacted a statute to provide for the general welfare by establishing a system of Federal old-age benefits and by assisting the states to make more adequate provision for aged persons, blind persons, dependent and crippled children, maternal and child welfare, public health, vocational rehabilitation, and the administration of unemployment compensation.

Social Security Board. The act established a Social Security Board composed of three members appointed by the President with the advice and the consent of the Senate for a period of six years. This board had certain duties in connection with the administration of the act. It also had the duty of studying and making recommendations as to (1) the most effective methods of providing social security and (2) as to legislation and administrative policy in respect to the purposes of the statute.

> Since 1946 the duties of the Social Security Board are performed under the direction of the Federal Security Agency.

Old-Age and Survivors Benefits. The act provides for a system of old-age and survivors insurance benefits to be paid out of a fund in the United States Treasury known as the "Federal Old-Age and Survivors Insurance Trust Fund."

Persons who have reached the age of sixty-five years and who have worked on jobs that are covered by the law are entitled to receive monthly old-age insurance benefits, provided they have earned enough from covered jobs during certain periods of time and have properly filed applications for benefits. The amount of each monthly benefit depends upon the worker's monthly average pay covered by the law with added credit for the number of years he has worked on such jobs. If the monthly benefit thus computed is less than $10, the benefit is increased to the sum of $10. In no case, however, will the monthly benefit exceed the sum of $85.

In addition to the monthly old-age benefits payable to an insured individual himself beginning at the age of sixty-five, monthly benefits are paid to dependent members of his family.

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[13] *Statutes at Large*, Vol. 49, Part I, Chapter 531.

Thus, when an insured individual receives his old-age benefits, additional benefits may be paid to his wife if she is sixty-five or over, or when she reaches the age of sixty-five, and to his children under eighteen years of age. The wife's benefits, as a dependent, continue until (a) she dies, (b) her husband dies, (c) she is divorced, or (d) she becomes entitled to insurance benefits in her own right equal to or in excess of her dependent benefits. A child's benefits, as a dependent, continue until (a) the child dies, (b) the child marries, (c) the child attains the age of eighteen, or (d) the child is adopted by an individual other than the individual with respect to whose wages such child is receiving dependent benefits.

After the death at any age of a fully insured individual, survivors benefits will be paid (a) to his widow if she is sixty-five or over, or when she reaches the age of sixty-five; (b) to his children until they are eighteen years of age; (c) to his widow of any age if she has such children in her care; (d) to his dependent parents if they are sixty-five, or when they reach the age of sixty-five, provided he leaves no widow or child who could become entitled to such benefits. The amount of monthly benefits a member of an insured individual's family may receive depends, within certain limits, on the amount of the primary benefit the individual had earned prior to his death.

If an insured individual leaves no survivor qualified for monthly benefits at the time of his death, a lump sum equal to six times his monthly benefit may be paid, in the order specified, (a) to widow or widower, (b) to child or children, or (c) to parent or parents. When none of the foregoing persons are living, the person who paid the burial expenses, if equitably entitled thereto, will be paid an amount equal to the amount of the burial expenses or six times the insurance benefit of the deceased, whichever is less.

> The assignment of the right to any future payments under the Federal old-age system is prohibited. (United States Code Annotated, Title 42, Sec. 407)

Employed individuals who are not expressly exempted by the Social Security Act are required to pay a social security tax specified in percentages by the act on his or her respective

wages up to a maximum of $3,000. The employee's tax is based on a sliding scale over a period of years, as provided for by the Social Security Act. The rate of tax may be changed only by action of the Congress of the United States. Employers are required to pay an excise tax based on pay rolls. The amount of the employers' excise tax in the case of each employee is the same as that paid by the employee.

> Social Security taxes and income taxes "are separate and distinct forms of taxation." (Smith v. Reynolds, 43 F. Supp. 510)

Individuals who are expressly excluded from receiving old-age benefits are not subject to the foregoing social security tax. Workers not included are agricultural, domestic, casual, ship, governmental, and charitable-organization employees.[14]

Aid to States for the Aged. The act provides for annual appropriations for payments to states which submit old-age assistance plans that meet the approval of the Social Security Board.

It is specifically required that state plans must (1) cover all parts of the state, (2) provide for financial participation by the state, (3) provide for a single state agency to administer or to supervise the administration of the plan, (4) provide for a fair hearing for one refused assistance, (5) provide methods of administration approved by the Social Security Board, (6) provide for reports that may be required by the Social Security Board, and (7) provide that, if the state collects from the estate of any recipient of old-age assistance, one half of the net amount shall be paid to the United States.

The Social Security Board is required to approve any state plan fulfilling the foregoing conditions, unless such plan includes one or more of three conditions to assistance that are expressly forbidden. The state plan could not have an age

[14] Employees of railroads, express companies, and sleeping-car companies, engaged in interstate commerce, are not included in the provisions for old-age benefits under the Social Security Act. Provision for these employees was made in two acts passed by Congress, known as the Federal Railroad Retirement Act of 1937 and the Carriers' Taxing Act of 1937. These acts provide benefits and impose taxes that are different in details from the benefits and the taxes that provide old-age benefits for employees in other industries, but the basic principles are the same.

requirement of more than sixty-five years before January 1, 1940, but now it may have a requirement of seventy years. It may not exclude any resident of the state who has resided therein five years during the nine years immediately preceding an application for assistance, and who has resided in the state continuously for one year immediately preceding such application. Finally, the plan may not have any citizenship requirement that excludes any citizen of the United States.

Aid to State Unemployment Compensation. The act provides for annual appropriations for assisting states in the administration of their unemployment laws. The Secretary of the Treasury is authorized to pay to a state having an unemployment compensation law approved by the Social Security Board, upon certification for payment by the Board, an amount that the Board determines to be necessary for the proper administration of the state's law. The Board's determination of such an amount is based upon the population of the state, upon an estimate of the number of persons covered by the state law and of the cost of proper administration of the law, and upon other factors that the Board finds relevant.

> Protection of the Federal treasury is part of the general welfare, and "grants to aid state agencies whose operations will tend to protect the Federal treasury are thus justified." (Chas. C. Steward Mach. Co. v. Davis, 89 F. [2d] 207)

The Board is required to approve any state unemployment law which provides that: (1) all compensation is to be paid through an agency approved by the Board; (2) no compensation shall be payable within two years after the first day of the period with respect to which contributions are required; (3) all money received in the unemployment fund shall be immediately paid to the Secretary of the Treasury to the credit of the Federal Unemployment Trust Fund; (4) all money withdrawn from the Unemployment Trust Fund shall be used solely in payment of compensation; (5) compensation shall not be denied an otherwise eligible individual for refusing to accept work (a) if the position offered is vacant due directly to a strike, lockout, or other labor dispute, (b) if wages, hours, or other conditions of the work offered are sub-

stantially less favorable than those prevailing for similar work in the locality, or (c) if as a condition of employment the individual must join a company union or resign from or refrain from joining any bona fide labor organization; and (6) all rights, privileges, or immunities conferred by the law are subject to amendment or repeal at any time.

Another provision of the Social Security Act requires other provisions to be in a state unemployment compensation law before the Social Security Board may make a certification for payment. The state law must provide for: (1) methods of administration approved by the Board; (2) opportunity for a fair hearing for one whose claim to compensation is denied; (3) the making of such reports as the Board may require and compliance with such provisions as the Board may find necessary to verify such reports; and (4) making available upon the request of any Federal agency charged with public employment the name, the address, the ordinary occupation, and the employment of each recipient of unemployment compensation, and a statement of his rights to further compensation.

> The Social Security Board is under a duty to stop payments to any state which fails to comply with the provisions of the statute. (United States Code Annotated, Title 42, Sec. 503-b and c)

The act requires all employers of eight or more persons, except those hiring employees in agricultural, domestic, ship, governmental, or charitable-organization services, to pay an excise tax equal to a specified percentage of their pay rolls. The tax was first computed at a rate of one per cent, but since January 1, 1938, it is computed at a rate of three per cent. The employers subject to this tax are entitled to credit up to ninety per cent of the Federal tax for what they pay into a state unemployment fund under a state law.

State Old-Age Assistance. The various states, in order to qualify for Federal aid in providing for the aged in need, have enacted or amended old-age assistance laws. Legislation of this kind is based on the theory that the public good is

promoted by the protection, welfare, and assistance of the aged in need. Although there are some differences in the statutes, one finds also considerable uniformity in the provisions of such laws because of the requirements of the Federal act. For this reason the discussion herein will be confined to the provisions of the law of one state.

The old-age assistance statute in the state of Michigan [15] created an old-age assistance bureau under the direction and the supervision of the director of the state welfare department. The bureau has power to make such rules and regulations as are necessary to carry out the provisions of the act. The director of the state welfare department is required to make such reports as may be demanded by the Federal Government and to make a report to the governor within ninety days after the close of each fiscal year.

The statute also created in each county a county old-age assistance board, consisting of the county welfare agent, as chairman, the probate judge, and the chairman of the superintendents of the poor. The county welfare agent is the direct representative of the old-age assistance bureau and is subject to the direction of the director of the state welfare department. He has custody of all files and records of matters pertaining to old-age assistance, and he receives applications for assistance.

The qualifications for old-age assistance under the statute are as follows:

(1) The applicant must have attained the age of sixty-five years. After January 1, 1940, however, assistance may be denied persons who are less than seventy years of age.

(2) The applicant must be a citizen of the United States.

(3) He must have been a resident of the state for at least ten years, unless Federal aid is received. In the latter case, he must have resided in the state for five years out of the immediate preceding nine years, and continuously resided in the state for one year next preceding his application.

(4) The applicant may not be, at the date of receiving aid, an inmate of any prison, jail, workhouse, insane asylum, or any other public reform or correctional institution.

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[15] *Public Acts, 1935*, No. 159.

(5) He must not have deserted his wife without cause for a period of six months during the preceding ten years, or failed to support her and his children under the age of sixteen years. The same rule applies to a wife in respect to desertion and to the support of her children whom she was bound to support.

(6) He must not have been within one year preceding the application for assistance a professional tramp or beggar.

(7) The applicant may not be one who has a child or other person responsible under the law of the state and found able to support him.

(8) He may not be one who has divested himself directly or indirectly of any property or income from property for the purpose of qualifying for assistance under the statute.

(9) He may not be one who has been convicted of a felony within five years immediately preceding his application for assistance.

(10) The applicant may not be one in need of continual institutional care. In such cases, however, the old-age assistance bureau may upon investigation assist such persons when properly cared for by relatives who are not legally required or themselves unable to care for such persons.

(11) The applicant must be one who is unable to earn regularly an income of at least one dollar a day on account of age, infirmity, or inability to obtain suitable employment.

In addition to the foregoing qualifications, there is another in the form of a property limitation. Assistance is not granted (a) to a person who owns property valued at more than $3,500, (b) to a person living with a husband or a wife who owns property, which together with property of the husband or wife exceeds a valuation of $3,500, or (c) to a person owning personal property to the value of $1,000, not counting household goods to the value of $500.

The amount of assistance is fixed in each case with due regard to the condition of the individual and the community. In no case does it exceed, when added to the applicant's other income, the sum of $30 a month. The income of an applicant from any property that does not produce a reasonable income is computed at three per cent of its value as determined by the old-age assistance bureau.

Upon the death of a person receiving assistance or the death of the survivor of a married couple, both of whom received assistance, the total amount paid as assistance and simple interest of three per cent a year must be taken from such person's estate ahead of general creditors. This money is shared by the state and the Federal treasuries. In this connection, the director of the state welfare department, to protect the interests of the state, may require, as a condition to the grant of assistance, a transfer to the state of all or any part of the real or personal property, or insurance, of an applicant for assistance. If the estate of one who received assistance is insufficient to defray funeral expenses, the director of the state welfare department is required to furnish a reasonable sum, but not to exceed $150, for such a purpose.

State Unemployment Compensation. The various states, in order to participate in the advantages available under the Federal Social Security Act, have enacted or amended unemployment laws. Legislation of this kind is based upon the theory that economic insecurity due to unemployment is a serious menace to the health, the morals, and the welfare of the people as a whole. One may find some differences in the statutes, but there is considerable uniformity in the provisions of such laws because of the requirements of the Federal act. The discussion herein will therefore be confined to the provisions of the law of one state.

The unemployment compensation statute of the state of Colorado [16] created two co-ordinate divisions in the Industrial Commission—the unemployment compensation division and the employment service division—to establish and maintain free public employment offices and to perform other services in connection with employment. Both divisions are subject to the supervision and the direction of the Industrial Commission, which is charged with the administration of the provisions of the statute.

The Industrial Commission is empowered to make, amend, or rescind such rules and regulations as are necessary for

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[16] *Public Laws, Third Extraordinary Session, 1936,* Ch. 2; *Amended, Session Laws, 1937,* Ch. 260.

the administration of the law. Such action may be taken in respect to general and special rules only after a public hearing, of which notice has been given. The Industrial Commission is also authorized to appoint state and local advisory councils, to demand that employing units keep records of information and make reports that it may desire, and to compel attendance of witnesses and the production of written evidence necessary in connection with a disputed claim of the administration of the law. The Industrial Commission is required to co-operate to the fullest extent with the Federal Social Security Board and to submit to the governor a report covering the administration and the operation of the statute during the preceding calendar year.

The statute provides that unemployment compensation shall become payable after January 1, 1939. Each eligible individual who is totally unemployed in any week shall be paid, with respect to such week, benefits at the rate of four per cent of his highest quarterly base period wages, but not more than $15 a week or less than either $5 or three fourths of his full-time weekly wage, whichever is the lesser. The Colorado law defines an individual's base period as "the period of twelve consecutive months ending December 31 immediately preceding the first day of the benefit year." The statute also provides for the determination of benefits in case of partial unemployment, in case of unemployment of part-time workers, and in case of unemployment of seasonal workers.

An unemployed individual is eligible to receive benefits under the statute with respect to any week only if the Commission finds that:

(1) He has registered for work at and thereafter has continued to report at an employment office in accordance with such regulations as the Commission may prescribe.

(2) He has made a claim for benefits in accordance with the provisions of the statute.

(3) He is able to work and is available for all work deemed suitable pursuant to the provisions of the statute.

(4) Prior to any week for which he claims benefits he has been totally or partially unemployed for a waiting period of two weeks. (These waiting periods need not consist of consecutive weeks.)

An individual is disqualified for benefits for the week (1) in which he left work voluntarily; (2) in which he was discharged for misconduct connected with his work; and (3) in which he failed, without good cause, either to apply for available, suitable work when so directed by the employment office, or to accept suitable work when offered to him, or to return to his customary self-employment (if any) when so directed by the commission. He is also disqualified for not less than the three or more than the fifteen weeks which immediately follow such week, as determined by the Commission according to the circumstances in each case. He is also disqualified for benefits for any week in which his total unemployment is due to a stoppage of work that exists because of a strike where he is or was last employed, unless he is not participating in or financing or directly interested in such strike, and unless he does not belong to a grade or class of workers of which, immediately before the commencement of the strike, there were members employed at the premises at which the strike occurs, any of whom are participating in or financing or directly interested in the strike.

An individual is not disqualified for refusing to accept new work under any of the following conditions: (1) If the position offered is vacant due directly to a strike, lockout, or other labor dispute; (2) if the wages, hours, or other conditions of the work offered are substantially less favorable to the individual than those prevailing for similar work in the locality; or (3) if, as a condition of being employed, the individual would be required to join a company union or to resign from or refrain from joining any bona fide labor organization.

The statute provides that a claim for benefits shall be made in accordance with such regulations as the Industrial Commission may prescribe. A representative of the Commission makes the initial determination of the validity of the claim. If an appeal is taken, a referee appointed by the Commission, after a fair hearing, affirms or modifies the findings of fact and the decision of the representative. Upon an appeal or on its own motion, the Commission may affirm, modify, or set aside any decision of the referee. The statute also provides that within twenty days after the decision of the Commission has become final, any party aggrieved thereby

may secure judicial review thereof by commencing an action against the Commission in the district court of the county in which the claim for benefits was filed, in the same manner as reviews in cases of workmen's compensation.

QUESTIONS

1. "An employee impliedly assents to the assumption of the ordinary risks of an industry." "An employee is paid a higher wage in consideration for the assumption of the ordinary risks of an industry." Do you agree with these statements?

2. Blackham and Theriault are discussing labor legislation. The former contends that the common-law rules governing the rights and duties of the employer were inadequate for the industrial conditions in connection with which they developed. The latter denies this and maintains that these rules are adequate to cope with modern business conditions. Do you agree with Blackham or Theriault?

3. William Roberts was employed to paint a house. While engaged in his work, he discovered smoke coming out of the bathroom window. He entered the house and attempted to extinguish the fire. In so doing, he suffered certain injuries. Thereafter Roberts brought proceedings to recover under the provisions of the workmen's compensation law. Was he entitled to judgment?

4. Hibbard maintains that under the Fair Labor Standards Act no worker, beginning in 1939, can work more than 40 hours a week or be paid less than 40 cents an hour. Do you agree with Hibbard?

5. It is contended that the Federal Social Security Act attempts to provide for the general welfare by establishing only a system of Federal old-age benefits. Do you agree?

6. A strike was called by the workmen employed by a given manufacturing company that was engaged in interstate commerce. The company contended that under the National Labor Relations Act such action on the part of the workmen was illegal. Do you agree?

7. Jackson, a boy thirteen years of age, is employed in a cotton mill. It is contended that Jackson is prohibited from working in such a place by the Fair Labor Standards Act. Do you agree?

8. A statute gives a lien to mechanics and laborers on the property of their employer for compensation due and unpaid. Cranson, who furnished materials to the employer, maintains that under this statute he has a preference over other creditors to the extent of the materials supplied by him. Is his contention sound?

9. An unemployed individual had taken the proper steps to make him eligible for unemployment compensation under a state law. When he applied for such benefits, it was shown that he had refused the offer of a position that was vacant as the result of a strike. Was he disqualified for benefits?

10. The Federal Safety Appliance Act provides that an employee whose injury is caused by a violation of the act on the part of the common carrier "shall not be deemed thereby to have assumed the risk thereby occasioned, although continuing in the employment of such carrier after the unlawful use of such locomotive, car, or train had been brought to his knowledge." Does this statute change the common-law rule governing the liability of the employer?

11. Elwell contends that all workers in businesses engaged in interstate commerce are subject to social security tax. Do you agree with his contention?

12. A company engaged in interstate commerce contributed financial support to a labor organization. A complaint was made to the National Labor Relations Board to the effect that the company was guilty of an unfair labor practice. Did the Board dismiss the complaint?

13. After being released from prison where he had been confined for committing a felony, Wendry begged during a period of six months. Eight months after his release from prison he reached the age of seventy-two years and applied for assistance under the old-age assistance law. Was he entitled to assistance?

CASES FOR REVIEW

1. The Sheboygan Airways, a corporation, employed Marshall Field to pilot its planes when carrying passengers for hire. One day Field, while piloting a plane with passengers, was killed as the result of a crash. In an action brought by his widow, Signa Field, to recover compensation under the workmen's compensation act, the corporation alleged that Field, in order to gratify his own or his passengers' desire, had voluntarily entered upon stunt or acrobatic flying by undertaking a power dive, which was contrary to the usual method of transporting passengers. If the allegation of the employer was true, was Mrs. Field entitled to judgment? (Sheboygan Airways v. Industrial Commission, 209 Wis. 352, 245 N. W. 178)

2. Lee Burroughs was the proprietor of a restaurant in the city of Lincoln, Nebraska. He employed Hankins to work for him as a cook. One day Hankins became angry and threw an object at Lawrence Allertz, who thereby suffered a personal injury. Thereafter Allertz brought an action against Hankins and Burroughs to recover damages arising out of the wrongful act of Hankins. Was he entitled to a judgment against Burroughs? (Allertz v. Hankins, 102 Nebr. 202, 166 N. W. 608)

3. The Chicago, Milwaukee and Puget Sound Railway Company employed Jones & Onserud to do certain grading and excavating pre-

paratory to the erection of a bridge. It agreed to pay the firm the actual cost of the work plus a fixed percentage to be added thereto as profit. The partners were to perform the work according to their own methods and with their own tools, materials, and employees, subject to one condition—that certain defined results be obtained. In an action brought by Murdock Campbell, an injured employee of the firm, it was contended that the firm was not an employee of the railway company. Do you agree? (Campbell v. Jones, 60 Wash. 265, 110 P. 1083)

4. Bonaventure Schreiber was the owner of some race horses. He entered into a contract with Mary Middendorf to employ her son, Leo von Graeffen, as a jockey. He later discharged von Graeffen as incompetent because the boy, although possessing the ordinary skill of a jockey, was unable to make Schreiber's horses win races. Mrs. Middendorf brought an action against Schreiber to recover damages for breach of contract arising out of an alleged wrongful discharge. Was she entitled to judgment? (Middendorf v. Schreiber, 150 Mo. A. 530, 131 S. W. 122)

5. The Detroit Saturday Night Company employed James Spooner to operate an engine and dynamo in the basement of a building. One evening Spooner went to an upper floor and volunteered as a personal favor to take some of his friends to a floor above in the elevator. While so doing, he received an injury that resulted in his death. His widow, Mary Spooner, brought an action against the Detroit Saturday Night Company to recover compensation under the workmen's compensation act. Was she entitled to judgment? (Spooner v. Detroit Saturday Night Co., 187 Mich. 125, 153 N. W. 657)

6. John Wannamaker and others, of Philadelphia, Pennsylvania, employed James P. Burke to assist in the cloth sponging department of their establishment. Burke, while engaged in his work, fell through a hole in the upper floor of the building, which had been left improperly guarded by a carpenter in charge of alterations. Burke brought an action against his employers to recover damages. Did the mere fact that the employee was injured while performing his duties render the employers liable under the common law? (Wannamaker v. Burke, 111 Pa. 423, 2 A. 500)

7. The Air Reduction Company employed Warren R. Walker as a research chemist to discover or invent some method or means of utilizing commercially the gas known as neon, which is found in small quantities in the atmosphere. A commercial use was discovered, and an invention was perfected and patented. The Air Reduction Company contended that it, and not Walker, had a right to the invention. Was this contention sound? (Air Reduction Co. v. Walker, 118 Misc. Rep. 827, 195 N. Y. S. 120)

8. The Mashek Chemical & Iron Company operated a plant at Wells, Michigan. A fire started near some charcoal cars and sawdust cars on the track of the company. James Smedley, who through curiosity went to

see the fire, volunteered to help extinguish the blaze. He suffered an injury as the result of the breaking of a ladder belonging to the company. Thereafter in an action brought against the company, he contended that he was an employee of the company at the time of his injury. Was this contention sound? (Smedley v. Mashek Chemical & Iron Co., 189 Mich. 64, 155 N. W. 357)

9. Andrea De Angelo was employed by the Boston Elevated Railway Company. One day he was engaged in cleaning a large machine while the wheels were in motion. The waste in his hand was drawn into the machine by suction caused by wind, and before he could let go of the waste his hand was also drawn in and injured. Subsequently De Angelo brought an action against the company to recover damages under the common law, basing his claim on the ground that his employer had not informed him of the danger. Was he entitled to judgment? (De Angelo v. Boston Elevated Ry. Co., 209 Mass. 58, 95 N. E. 102)

10. Jackson, who was employed by the Norfolk & Western Railroad Company, was killed while using certain appliances that had been furnished to him by the employer. There were newer appliances on the market for use in the work that Jackson was doing at the time of his injury. This fact, contended the administrator of the estate of Jackson, rendered the company liable under the common law for damages arising out of breach of duty. Was this contention sound? (Norfolk & W. R. Co. v. Jackson, 85 Va. 489, 8 S. E. 370)

11. Arthur Marineau was employed by the Humbird Lumber Company as a setter on a log carriage in a sawmill. He was injured as the result of the operation of a roller table and shaft connected thereto. The injury was caused without fault on the part of the company, because the table and the shaft were constructed and maintained so as to be of the same type and quality in general use in all well-equipped sawmills. Thereafter Marineau brought an action against the company to recover damages under the common law. The company contended that the injury was the result of a risk assumed by the employee. Was Marineau entitled to judgment? (Marineau v. Humbird Lumber Co., 28 Ida. 335, 154 P. 492)

12. John B. McDonald was engaged in constructing a tunnel as a part of a rapid transit subway in the city of New York. While the tunnel was being driven through rock, an employee, Louis Toppi, was killed by the fall of a piece of rock weighing about 120 tons. In an action brought by Florentia Toppi against McDonald, it was contended that the tunnel was a place of work within the rule that requires an employer to provide a safe place of work. Do you agree? (Toppi v. McDonald, 128 App. Div. 443, 112 N. Y. S. 821)

13. Andrew Ferguson and Poling were employed by the Glady Fork Lumber Company. They were engaged in a task in connection

with the repair of railroad cars. Poling negligently caused some cars to be shoved against a car upon which Ferguson was then working. As a result Ferguson suffered a personal injury. Thereafter he brought an action against the lumber company to recover damages under the common law. Was he entitled to judgment? (Ferguson v. Glady Fork Lumber Co., 72 W. Va. 278, 78 S. E. 689)

14. J. D. Van Winkle by written agreement employed W. T. Satterfield to work in a bookstore for a period of one year. Because a post office was located in the rear of the store, Van Winkle insisted that Satterfield work on Sundays, guarding the goods. When he refused to do so, Satterfield was discharged. Thereafter he brought an action against Van Winkle to recover damages for breach of contract. Was Satterfield entitled to judgment? (Van Winkle v. Satterfield, 58 Ark. 617, 25 S. W. 1113)

15. Crepin and another employed Taubles under an agreement which provided that they would pay Taubles for his time and services while employed, even though they discharged him from their service for misconduct or incapability. Taubles was discharged for misconduct and incapability. Thereafter, when sued by the assignee of the claim of Taubles for compensation, Crepin and his partner contended that the foregoing provision was void. Do you agree with this contention? (Edwards v. Crepin, 68 Calif. 37, 8 P. 616)

16. Henry Thomas, who was employed by the Hoosier Stone Company, was directed to carry some iron pipe to the blacksmith shop. He chose to carry a bent piece, placing it on his shoulder. As the result of the weight and the shape of the pipe, he walked unsteadily. The path over which he had to carry the pipe was in one place not more than a foot wide, with a cavity on one side and a perpendicular wall on the other, all of which Thomas knew. At the turn in the path he fell into the cavity, suffering a personal injury. Thereafter Thomas brought an action under common law to recover damages from the stone company. Was Thomas entitled to judgment? (Thomas v. Hoosier Stone Co., 140 Ind. 518, 39 N. E. 500)

17. Alexander Pantages was the proprietor of a vaudeville circuit on the Pacific Coast. Through an agent, Louis Pincus, he entered into a contract to employ Andy Amann and Frances Hartley, engaged in business under the name of Amann & Hartley, to give performances in the west, beginning three months later at Calgary. In an action brought by the performers against Pantages, it was contended that a tender of performance in New York City fulfilled their duty under the agreement. Do you agree? (Amann v. Pantages, 90 Wash. 271, 155 P. 1070)

CHAPTER IV

NEGOTIABLE INSTRUMENTS

Part I—General Considerations

Introduction. Negotiable instruments are the most common credit devices utilized in business today. They consist of written obligations, such as checks and promissory notes, which, when in the proper form, may be transferred from hand to hand as a substitute for money.

The use of negotiable instruments is of daily occurrence. The average man pays for his supply of coal, his overcoat, and innumerable other things that he buys with a check. When he is in need of extra money to pay his taxes or to meet some other obligation, he borrows money from a bank or a friend and gives as evidence of his indebtedness a promissory note. The obtaining of credit for goods or for money by means of negotiable instruments is a general practice in business; indeed, most modern financial transactions involve the use of these devices. The use of negotiable instruments is possible because negotiable instruments constitute a special class of contracts possessing peculiar advantages in commercial use not enjoyed by other transferable claims that may be transferred only by assignment.[1]

Ordinarily all instruments at common law were nonnegotiable. The theory of negotiability, as distinguished from that of assignability, came from the customs of merchants and traders. When an instrument was assigned, the obligor could always set up defenses against the transferee which he could set up against the transferor. Under these circumstances, nonnegotiable instruments were not acceptable and consequently not used as a substitute for money, because of the possibility that the obligor, irrespective of his financial condition, might have a claim against the original obligee which could be deducted when the contract was presented for payment by the transferee. Hence a practice was evolved among

[1] Claims transferable by assignment have been discussed in Chapter I, pp. 141 and 142.

the merchants and traders under which certain holders of instruments in a specified form were permitted to enforce the contract in their own names, free from all claims against original obligees. These instruments came to be known as negotiable instruments.

Because of the confusion in the law of negotiable instruments in this country, as the result of conflicting statutes and court decisions, a Uniform Negotiable Instruments Law [2] was proposed to secure uniformity in this branch of the law. This statute has been substantially adopted in all the states.

Definition. A negotiable instrument may be defined, as in the preceding section, in terms of its use. As an aid in identifying such an instrument, the definition must be in terms of the form of such an obligation.

A *negotiable instrument* is a contractual obligation, in writing and signed by the party executing it, containing an unconditional promise or order to pay a sum certain in money on demand, or at a fixed or determinable future time, payable to bearer or to the order of a specified person. When another person is ordered to pay, such person must be named or otherwise indicated in the instrument with reasonable certainty.[3]

All other contractual obligations are technically nonnegotiable instruments, although some of them have been given, partially or fully, the characteristic of negotiability. It should be recalled, in this connection, that although a contract is nonnegotiable, it may in many instances be transferred. The transfer of one's rights under such circumstances is known as an *assignment.*[4]

Classification. Negotiable instruments may be classified in terms of their form into three general classes:

(1) Promissory notes
(2) Drafts, technically known as bills of exchange
(3) Checks

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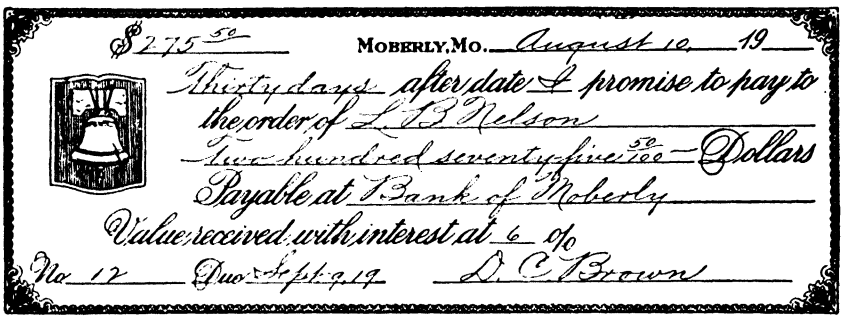
[2] Hereinafter cited in footnotes as N. I. L.
[3] N. I. L., §1.
[4] *Ante*, p. 142.

Promissory Notes. In general, any written obligation whereby one person promises to pay another a sum of money is a promissory note. Although nonnegotiable notes may be valid and enforceable, we are concerned here with negotiable promissory notes. Our definition must therefore be in terms of negotiability. The usual common-law definition of a negotiable promissory note has been codified by the Negotiable Instruments Law which states that it "is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order or to bearer." [5] It should be noted in this connection that a promissory note has two parties thereto, namely, the one who makes the promise and the one who is entitled to payment. The elements necessary to negotiability will be discussed in Part II.


275^{50} MOBERLY, MO. August 10, 19__

Thirty days after date I promise to pay to the order of L. B. Nelson

Two hundred seventy-five $^{50}/_{100}$ Dollars

Payable at Bank of Moberly

Value received with interest at 6 %

No. 12 Due Sept. 9, 19__ D. C. Brown

PROMISSORY NOTE

There exist a few special forms of negotiable promissory notes, such as national and Federal reserve bank notes, United States treasury notes, and United States silver and gold certificates. A certificate of deposit, which is an instrument in the form of a receipt issued by a bank for a specified sum of money, is treated as a promissory note and is negotiable when it is in the proper form. Coupons and interest certificates attached to certain bonds are in the nature of promissory notes, and they are usually negotiable in form.

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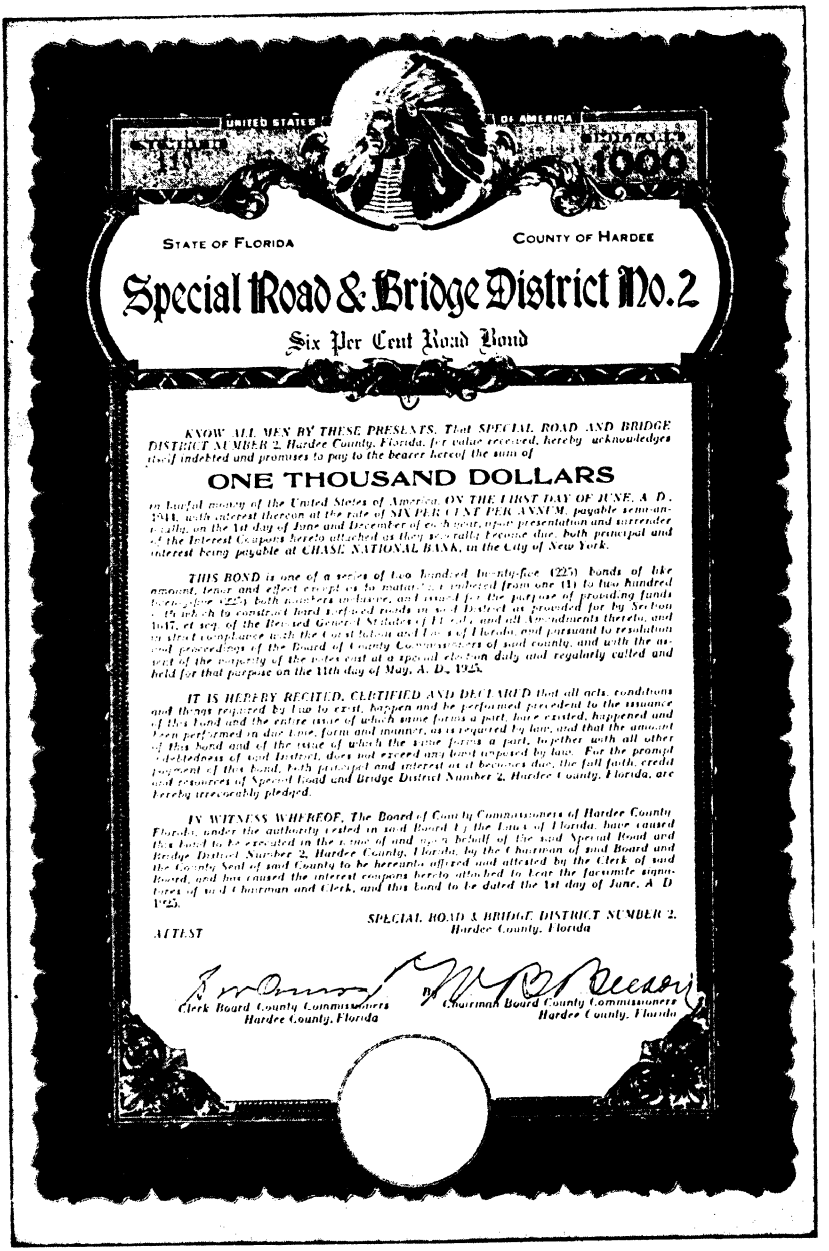
[5] §184.



UNITED STATES OF AMERICA

STATE OF FLORIDA COUNTY OF HARDEE

Special Road & Bridge District No. 2

Six Per Cent Road Bond

KNOW ALL MEN BY THESE PRESENTS, That SPECIAL ROAD AND BRIDGE DISTRICT NUMBER 2, Hardee County, Florida, for value received, hereby acknowledges itself indebted and promises to pay to the bearer hereof the sum of

ONE THOUSAND DOLLARS

in lawful money of the United States of America, ON THE FIRST DAY OF JUNE, A. D. 1941, with interest thereon at the rate of SIX PER CENT PER ANNUM, payable semi-annually, on the 1st day of June and December of each year, upon presentation and surrender of the Interest Coupons hereto attached as they severally become due, both principal and interest being payable at CHASE NATIONAL BANK, in the City of New York.

THIS BOND is one of a series of Two Hundred Twenty-five (225) bonds of like amount, tenor and effect except as to maturity, numbered from one (1) to two hundred twenty-five (225), both numbers inclusive, and issued for the purpose of providing funds with which to construct hard surfaced roads in said District as provided for by Section 6587, et seq. of the Revised General Statutes of Florida, and pursuant to resolution in strict compliance with the Constitution and Laws of Florida, and pursuant to resolution and proceedings of the Board of County Commissioners of said county, and with the assent of the majority of the votes cast at a special election duly and regularly called and held for that purpose on the 11th day of May, A. D., 1925.

IT IS HEREBY RECITED, CERTIFIED AND DECLARED that all acts, conditions and things required by law to exist, happen and be performed precedent to the issuance of this bond and the entire issue of which same forms a part, have existed, happened and been performed in due time, form and manner, as is required by law, and that the amount of this bond and of the issue of which the same forms a part, together with all other indebtedness of said District, does not exceed any limit imposed by law. For the prompt payment of this bond, both principal and interest at maturity, the full faith, credit and resources of Special Road and Bridge District Number 2, Hardee County, Florida, are hereby irrevocably pledged.

IN WITNESS WHEREOF, The Board of County Commissioners of Hardee County, Florida, under the authority vested in said Board by the Laws of Florida, have caused this bond to be executed in the name of and upon behalf of the said Special Road and Bridge District Number 2, Hardee County, Florida, by the Chairman of said Board and the County Seal of said County to be hereunto affixed and attested by the Clerk of said Board, and has caused the interest coupons hereto attached to bear the facsimile signatures of said Chairman and Clerk, and this bond to be dated the 1st day of June, A. D. 1925.

SPECIAL ROAD & BRIDGE DISTRICT NUMBER 2,
Hardee County, Florida

ATTEST

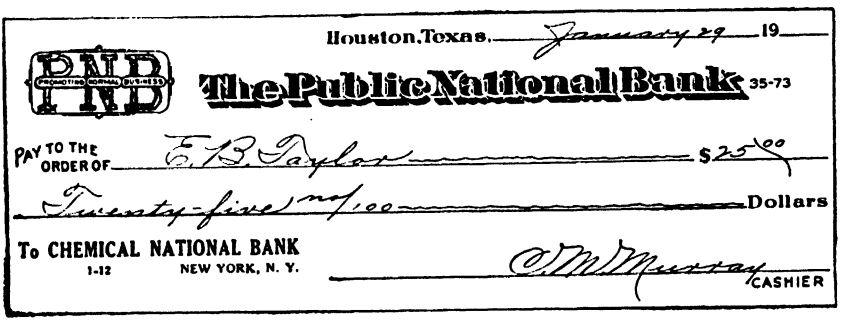
Clerk Board County Commissioners
Hardee County, Florida

By Chairman Board County Commissioners
Hardee County, Florida

BOND

> "Each coupon bears upon its face its maturity date, and the entire series, maturing periodically, covers and provides for the interest on the bond until its maturity. Like it these coupons themselves possess qualities of negotiability from hand to hand after detachment from the bond or other indebtedness of which they are a part." (Hamilton v. Wheeling Public Service Co., 88 W. Va. 573, 107 S. E. 401)

Drafts or Bills of Exchange. A negotiable draft or bill of exchange, as defined at common law and in the Negotiable Instruments Law, is "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order or to bearer." [6] It should be noted in this connection that a draft or bill of exchange has three parties thereto: namely, the one who draws the order, the one who is to receive payment, and the one who is ordered to make the payment. The elements necessary to negotiability will be discussed in Part II.


Houston, Texas. January 29 19—

PNB PROMOTING NORMAL BUSINESS — The Public National Bank 35-73

PAY TO THE ORDER OF E. B. Taylor $25.00

Twenty-five and no/100 Dollars

To CHEMICAL NATIONAL BANK 1-12 NEW YORK, N. Y.

O. M. Murray CASHIER

BANK DRAFT

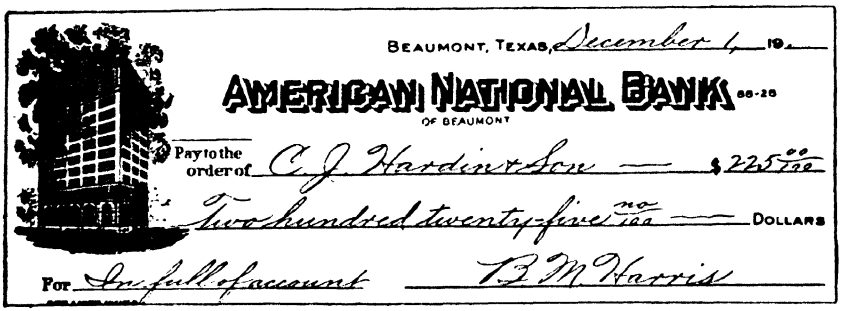
Drafts are classified upon the basis of time when they are payable, as demand, time, and sight drafts. They are also classified as foreign drafts and inland drafts. A foreign draft or bill of exchange is one drawn in one country or state and made payable in another. In respect to negotiable instruments, the several states of the United States are considered foreign to each other. The Negotiable Instruments Law provides that "an inland bill of exchange is a bill which is, or

[6] §126.

on its face purports to be, both drawn and payable within this state. Any other bill is a foreign bill. Unless the contrary appears on the face of the bill, the holder may treat it as an inland bill." [7]

> The Connecticut Electric Manufacturing Company, in New York, executed a draft payable to C. B. Richard & Co., drawn on M. J. Gourland, Inc., at Kobe, Japan. The instrument, drawn in New York and payable in Japan, showed on its face that it was a foreign bill. (Richard v. Connecticut Mfg. Co., 200 App. Div. 681, 194 N. Y. S. 497)

Checks. A check is a peculiar form of bill of exchange. It is "a bill of exchange drawn on a bank payable on demand." [8] Another distinguishing feature is that a check presupposes funds deposited with the bank drawn upon, for the purpose of complying with the order to pay. Except as hereinafter noted, the rules governing drafts apply also to checks.



BANK CHECK

Parties. The names given to some of the parties of a negotiable instrument vary according to the form of the instrument. Other parties are known by the same name, irrespective of the form of the instrument.

Maker. The maker is one who executes a promissory note. In other words, the party to a promissory note who promises to pay is known as the maker.

Drawer. The drawer is one who executes a draft or bill of exchange (including checks). In other words, the party to a draft who orders the payment is called the drawer.

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[7] §129.
[8] N. I. L., §185.

Payee. The party to whose order any negotiable instrument is made payable is known as the payee.

Drawee. The drawee is one to whom a draft, bill of exchange, or check is addressed. In other words, the person ordered to pay the instrument is called the drawee.

Acceptor. A drawee who signifies his assent to the order of the drawer is known as an acceptor.

Indorser. One who transfers an instrument by indorsement is known as an indorser.

Indorsee. The party to whom an instrument is transferred by indorsement is called the indorsee.

Bearer. Any person in possession of a draft or a promissory note that is payable to bearer is called the bearer.

Holder. The payee or the indorsee of a promissory note or a draft, who is in possession of it, or the bearer thereof, is known as the holder. Note in this connection that all bearers are holders, but that not all holders are bearers.

Holder in Due Course. One who has taken a negotiable instrument complete and regular upon its face before it is due, in good faith, for value, and without notice of any infirmities or defects, is a holder in due course. Such a holder has special rights not possessed by other holders. These rights will be discussed later.

Consideration. Except as hereinafter noted, a negotiable instrument requires a consideration, as in the case of ordinary contracts, in order to be enforceable by "any person not a holder in due course." [9] It should be noted that the absence or failure of consideration is no defense against a holder in due course or one who claims through a holder in due course. The transferees subsequent to a holder in due course are protected for the benefit of the holder in due course, who, if they were not protected, would be seriously handicapped in the disposal of the instrument.

> "A holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect to all parties prior to the latter." (Negotiable Instruments Law, Sec. 58)

[9] N. I. L., §28.

When an action is brought on a negotiable instrument, it is presumed that consideration has been given for the instrument. "Every negotiable instrument is deemed prima facie to have been issued for valuable consideration; and every person whose signature appears thereon to have become a party thereto for value." [10] In other words, unlike the procedure in an action on an ordinary contract, the plaintiff is not required to allege and prove that consideration has been given in order to establish a cause of action. The presumption may, however, be challenged by the defendant when lack of consideration is a defense against the party bringing the action.

> M. B. Parr received nothing in return for a note she executed and delivered to her sister. During subsequent litigation, the court declared: "In the instant case, the accommodation maker, Modena Bates Parr, was entitled to the defense of absence of consideration if appellant was not a holder in due course, but the burden was on her to prove the absence of consideration." (National City Bank v. Parr, 205 Ind. A. 108, 185 N. E. 904)

As in the case of other contracts, the sufficiency and adequacy of the consideration as compared to the obligation is immaterial, although the consideration may be defined in terms of value. It is well settled that consideration consists of giving value, but courts have not been uniform in their decisions as to what constitutes value. The Negotiable Instruments Law states that "value is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value, and is deemed such whether the instrument is payable on demand or at a future time." [11] It also provides that a holder who has a lien on the instrument is deemed to have given value to the extent of the lien. When value has once been given, subsequent holders are treated as holders for value in respect to all parties to the instrument prior to that time.

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[10] N. I. L., §24.
[11] §25.

Delivery. A negotiable instrument is inoperative until it has been delivered, but a delivery is presumed until the contrary is proved. The instrument may be delivered actually or constructively. In case of the former there is a physical passing of the instrument with the intent to transfer the right of possession. In the latter instance the actual possession is with another or, in some cases, with the party making the transfer. In either case delivery is a question of intent. Thus one court stated that "the placing of a note or other instrument in the hands of another, though [that person be] the payee of the note, does not conclusively establish a delivery of the note or instrument, within the legal meaning of that word. Delivery is a question of intent, and depends on 'whether the parties at the time meant it to be a delivery to take effect at once.' " [12] The delivery may also be conditional, at least between the original parties or parties with notice.

> 'As between immediate parties, and as regards a remote party other than a holder in due course, * * * the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument." (Negotiable Instruments Laws, Sec. 16)

In connection with the rule that a negotiable instrument is not effective until a delivery is made, consideration must be given to two situations in which apparent exceptions are made. First, the maker or drawer may be estopped by his conduct to deny delivery; and, second, the authority of an agent to make delivery may be implied. In respect to the first situation the Negotiable Instruments Law has made a drastic change in the common-law rule in many states. It states that "where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him is conclusively presumed." [13] Under this rule, if an undelivered complete instrument is stolen, it is valid in the hands of a holder in due course.

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[12] *Gross* v. *Arnold*, 177 Ill. 575, 52 N. E. 867.
[13] §16.

QUESTIONS

1. "The negotiable instrument is a common form of credit device." What is meant by this statement?

2. In a course on money and banking the following question was asked: "Why were nonnegotiable contracts not acceptable as a substitute for money?" One student stated that the reason was that nonnegotiable contracts could not be transferred. Do you agree with this answer?

3. Harley executes a negotiable instrument in the form of an order addressed to Briggs directing him to pay a certain amount to Crandle. How are the parties to this instrument described?

4. Wagnalls gratuitously executed a negotiable instrument payable to the order of Bassett, in order that the latter could discount it at the bank and pay his taxes with the proceeds. Bassett did not negotiate the instrument but brought an action against Wagnalls on it at maturity. Was he entitled to judgment?

5. Creer executed a note for $75, payable to the order of Jenkins. The note, undelivered, was found among the effects of Creer upon his death. Did Jenkins have any rights on the note?

6. Leroy is suing McBain on a negotiable promissory note. The latter contends that the former cannot recover because he failed to allege and prove that the instrument was issued for valuable consideration. Is his contention sound?

7. The payee of a negotiable instrument indorsed and delivered it to one of his creditors in payment of an old debt. It later developed that the payee had secured the instrument by means of a fraud. When the creditor sued on the instrument, the case turned on whether he had given value for the instrument. He contended that he had. Do you agree?

8. Tompkins issues a negotiable note without consideration to Behrns who sells it to Bullock. The latter transfers the instrument without consideration to Kenny who brings action on it against Tompkins. Is Tompkins entitled to the defense of lack of consideration?

9. F. A. Carter and another executed a promissory note for $601.85. The consideration therefor was the right to purchase and to sell certain tools in the state of South Carolina, which turned out to be of slight value because of the quality of the tools. When an action was brought on the note by W. H. Jackson, the payee, it was contended that the giving of value does not require a consideration of any particular monetary value. Do you agree?

10. Mulroy executes a negotiable note payable to Luden but decides not to deliver it to him. The latter grabs the instrument and runs away. Later he sells the instrument to a holder in due course who brings an action on it against Mulroy. Is Mulroy liable on the note?

Part II—Form and Contents

Writing and Signature. The function of a negotiable instrument as a credit device is accomplished because it serves as a substitute for money. In order that it may do so, the instrument must be in writing and signed by the parties executing it. The Negotiable Instruments Law expressly provides that a negotiable instrument must be in writing and signed by the maker or drawer.[1] This does not mean, however, that it must be written by hand. For example, it is sufficient if the instrument is engraved or printed.[2] In the absence of statutes, the writing may be by pencil as well as by pen, but, of course, the possibility of easier alteration makes the former undesirable. Because they are in writing, negotiable instruments are governed by the parol evidence rule which has been previously mentioned. The writing may be on parchment, paper, or any substitute therefor; and no particular form or style, except as hereinafter noted, is required. In case of conflict between written and printed provisions, the former prevail.

> "Where the sum payable is expressed in words and also in figures and there is a discrepancy between the two, the sum denoted by the words is the sum payable; but if the words are ambiguous or uncertain, reference may be had to the figures to fix the amount." (Negotiable Instruments Law, Sec. 17-1)

Although the signature of the maker or drawer usually appears in the lower right-hand corner of the instrument, it is in fact immaterial where it is placed. It may be at the top, on the back, across the face, or in the body of the instrument. A signature written in an unusual place, however, may not clearly indicate the capacity in which the party making it intended to sign, in which case by a provision in the Negotiable Instruments Law he is deemed an indorser.[3] The signature may be made by any authorized agent; it may consist of the full name or of any mark or symbol adopted for that purpose.

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[1] §1.
[2] *Pennington* v. *Baehr*, 48 Calif. 565.
[3] §17-(6).

To illustrate, the signature may be initials only, figures, or a mark.[4] The Negotiable Instruments Law also expressly provides that "one who signs in a trade or assumed name will be liable to the same extent as if he had signed in his own name." [5] In the absence of statute, the signature may be by pencil, by print, or by stamp.

Order or Promise to Pay. A negotiable instrument must contain an unconditional order or promise to pay. This rule of the common law is codified by the Negotiable Instruments Law.[6] No particular words are necessary so long as it is clear that the maker or drawer undertakes to promise or to order payment. Thus, when the maker employs such phrases as, "I certify to pay," "obliges himself to pay," or "borrowed of," a promise is implied although the word "promise" is not used.[7] Although words, in order to constitute an order, must indicate more than a request, the use of civil or polite words, such as "please," in directions to pay does not preclude the directions from being an order.

> A claim was made on the following memorandum: "I owe Jean Tomkiewicz 1,000 dollars. (Signed) Erwin Linkman, M. D." It was held that the writing, containing no express or implied promise, was not a note. (In re Linkman's Estate, 191 Wis. 353, 210 N. W. 705)

An instrument containing an order or a promise to pay may be a draft or a note, but it is not negotiable unless such order or promise is certain. In other words, the order or promise must be absolute and unconditional. For example, an instrument which contains a promise to pay a given sum for the construction of a building, provided the building is placed in a specified location, is nonnegotiable.[8]

> Henry E. Price executed and delivered to Edward F. Riley a note payable ninety days after date, but his promise was conditioned on "when Postoffice Department accepts my building from me." The note, having a conditional promise, was nonnegotiable. (Devine v. Price, 152 N. Y. S. 321)

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[4] *McGowan* v. *Collins*, 154 Ala. 299, 46 S. 750.
[5] §18.
[6] §1—(3).
[7] *Woodfolk* v. *Leslie*, 11 S. C. L. 585.
[8] *Hart* v. *Taylor*, 70 Miss. 655, 12 S. 553.

Whether an instrument contains a conditional order or promise is to be determined from its face. It follows that a condition not in the body of the instrument but which appears in a collateral agreement does not affect the negotiability of the instrument. An order for the payment of money out of a particular fund is not negotiable, for in such a case the order or promise "is not unconditional." [9] If, however, the reference to a particular fund is merely to indicate a source of reimbursement for the drawee, the order is absolute. "The true test would seem to be whether the drawee is confined to the particular fund, or whether, though a specified fund is mentioned, he would have the power to charge the bill up to the general account of the drawer if the designated fund should turn out to be insufficient. In the final analysis of each case, it must appear that the alleged bill of exchange is drawn on the general credit of the drawer." [10]

Payable in Money. A negotiable instrument must call for payment in money. If the order or promise is for anything else, the instrument is not negotiable. For example, an instrument which contains a promise to issue stock or deliver goods is not negotiable.[11] This is also true, except as noted below, where a promise or order to pay money is coupled with a collateral agreement to do something else. "As notes and bills are designed to circulate freely, and to take the place of money in commercial transactions, sound policy would seem to dictate that they should be in a form as concise as possible, and that the obligation assumed by the maker or makers should be expressed in plain and simple language. It is easy to foresee that if parties are permitted to burden negotiable notes with all sorts of collateral engagements, they will be frequently used for the purpose of entrapping the inexperienced and the unwary into agreements which they had no intention of making and against which the law will afford no redress." [12]

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[9] N. I. L., §3.
[10] *Munger* v. *Shannon*, 61 N. Y. 253.
[11] *Killan* v. *Schoep*, 26 Kans. 310.
[12] *Com'l Nat'l Bank* v. *Consumer's Brewing Co.*, 16 App. (D. C.) 186.

R. E. Morrow purchased an automobile and a truck from B. E. Gregory. In part payment he gave two notes, totaling $650, each payable in "lumber or boxes." The notes, not being payable in money, were nonnegotiable. (Gregory v. Morrow, 4 Wash. [2d] 144, 102 P. [2d] 699)

At one time courts frowned upon all agreements to perform acts in addition to agreements to pay money. Such obligations were regarded as " 'luggage' which negotiable paper, riding as it does on the wings of the wind, is not a courier able to carry." [13] Some courts in this country, in view of modern business needs, have modified the rule so as to permit the use of certain collateral undertakings, deemed beneficial to business, without affecting the negotiability of the instrument. In accordance with this trend, the Negotiable Instruments Law provides that the "negotiable character of an instrument otherwise negotiable is not affected by a provision which (1) authorizes the sale of collateral securities in case the instrument is not paid at maturity; (2) authorizes a confession of judgment if the instrument is not paid at maturity; (3) waives the benefit of any law intended for the advantage or protection of the obligor; or (4) gives the holder an election to require something to be done in lieu of payment of money." [14] As an example of the last case, an instrument that read "I promise to pay Paul Poole or order $750 or 1,000 bushels of wheat, payable at his option" would be considered negotiable, for it would meet the requirement of a call for money although it gives the holder the election to require something to be done in lieu of the payment of money. If the instrument had called for the payment of $750 in wheat, it would have been nonnegotiable because it did not call for payment in money.

Clauses for confession of judgment may be invalid under statutes such as one in Florida which reads: "All powers of attorney for confessing or suffering judgment * * * made or to be made by any person whatsoever within this State, before such action brought, shall be absolutely null and void." (Carroll v. Gore, 106 Fla. 582, 143 S. 633)

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[13] *Woods* v. *North*, 84 Pa. 407.
[14] §5.

The instrument must call not only for payment in money but also for a sum certain. In case of conflict between marginal figures and the amount written in the body of the instrument, the latter prevails. An instrument calling for the payment of unliquidated damages is nonnegotiable. On the other hand, a provision for interest or for payment by installment, or a provision that upon the default of interest or payment of any installment the principal shall become due, does not render the instrument nonnegotiable. Most courts hold that a provision to add exchange to the amount payable does not affect negotiability. This is also true of a provision for the addition of the costs of attorney's fees in case of nonpayment at maturity. These rules have been adopted by the Negotiable Instruments Law.[15]

Time of Payment. A negotiable instrument must be payable at a time certain to arrive. Thus, if it is payable "when circumstances permit," "when able," or "when convenient," the instrument is nonnegotiable.[16] The term *time certain* means that it must be payable on demand, or at a fixed or a determinable future time. In other words, this means that the instrument must be payable at all events. An instrument is payable on demand when it is payable at sight or on presentation; when it expressly states that it is payable on demand; or when it mentions no time of payment. It is also payable on demand, as "regards the person so issuing, accepting, or indorsing it," when issued, indorsed, or accepted after maturity.[17]

> W. B. Roulstone executed and delivered to G. C. Warner a note reading in part: "On ———, for value received, the undersigned hereby promises to pay." Because the note contained a blank for the date of payment, it was payable on demand. (Chelsea Exchange Bank v. Warner, 202 App. Div. 499, 195 N. Y. S. 419)

What constitutes a "determinable future time" is sometimes a more difficult question to solve. This term means that

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[15] §2.
[16] *Rowlett* v. *Lane*, 43 Tex. 274.
[17] N. I. L., §7.

the instrument is payable upon or at a specified time after the happening of a contingency which is bound to happen, although the exact time is unknown. To illustrate, an instrument payable one month after the death of a specified person is negotiable, because the event upon which judgment depends is certain to happen.[18] If, however, the event is not certain to happen, as where the instrument is payable when a certain person reaches majority or is married, the instrument is not payable at a determinable future time and is therefore non-negotiable.

> George H. Smith executed and delivered to Pietro Tassi a note payable "on arrival at port of destination of the steamer called 'The Lykus.'" The instrument was non-negotiable because the time of payment was not certain to arrive. (The Lykus, 36 F. 919)

The Negotiable Instruments Law provides that an instrument is payable at a future determinable time when "expressed to be payable (1) at a fixed period after date or sight; (2) on or before a fixed or determinable future date specified therein; or (3) on or at a fixed period after the occurrence of a specified event, which is certain to happen though the time be uncertain." [19] The act also adopts the common-law rule that when an instrument is payable upon a contingency, the happening of the event does not make the instrument negotiable.

To Order or to Bearer. A negotiable instrument must be payable "to order" or "to bearer." Although these words are commonly used, other words, such as "assigns" or "holder," may be employed in some instances when they are intended as a substitute. "Words are but the signs; thought is chiefly valuable; and when, for a sufficient consideration, the minds of the parties have concurred in an agreement, there is a contract, and it must be executed as they intended, unless forbidden by law. 'Order' or 'bearer' are convenient and expressive, but they are clearly not the only words which will communicate the quality of negotiability." [20]

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[18] *Feeser* v. *Feeser*, 93 Md. 716, 50 A. 406.
[19] §4.
[20] *Raymond* v. *Middleton*, 29 Pa. 529.

Whether the requirement of "order or bearer" is met by the term "Payable on return of this certificate properly endorsed," is a point upon which courts have differed. One court stated: "This language can have but one logical meaning, and the necessary implication arising therefrom can only be that the instrument is payable to the depositor, or to her order." (Felton v. Commercial Nat. Bank, 39 Ohio A. 24, 177 N. E. 52)

An instrument payable to order may be drawn in two ways. It may be payable "to the order of a specified person" or "to a specified person or his order." On the other hand, an instrument payable to bearer may be indicated in various ways.

The Negotiable Instruments Law, substantially adopting the common-law rules, provides that an instrument is payable to bearer "(1) when it is expressed to be so payable; (2) when it is payable to a person named therein or bearer; (3) when it is payable to the order of a fictitious or nonexisting person, and such fact was known to the person making it so payable; (4) when the name of the payee does not purport to be the name of any person; or (5) when the only or last indorsement is an indorsement in blank." [21]

Payee and Drawee. When an instrument is payable to order, the payee must be named, or indicated in some other way, so that he may be identified with reasonable certainty. At common law it was held that, on the grounds of uncertainty, an instrument could not be payable in the alternative to two or more payees. For the same reason some courts held that an instrument could not be made payable to the holder of an office for the time being. In some states, if the maker was named as payee, the instrument was not considered as payable to order. These questions have been settled by the Uniform Negotiable Instruments Law which provides that an instrument may be "payable to the order of (1) a payee who is not maker, drawer, or drawee; (2) the drawer or maker; (3) the drawee; (4) two or more payees jointly; (5) one or some of several parties; or (6) the holder of an office for the time being." [22]

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[21] §9.
[22] §8.

"When an instrument is drawn or indorsed to a person as 'Cashier' or other fiscal officer of a bank or corporation, it is deemed prima facie to be payable to the bank or corporation of which he is such officer, and may be negotiated by either the indorsement of the bank or corporation, or the indorsement of the officer." (Negotiable Instruments Law, Sec. 42)

A bill of exchange must name the drawee or in some manner indicate him with reasonable certainty. If the drawer names himself as drawee, the holder may elect to treat the instrument as a bill or a note. The Negotiable Instruments Law adopts this rule and also gives the holder this right when the drawee is fictitious or lacks capacity to contract.[23] There may be two or more drawees if they are addressed jointly, but there cannot be two or more in the alternative or in succession. On the other hand, it is permissible for the drawer or any indorser of a bill to indicate a person to whom the instrument may be presented in case of dishonor by the drawee. "Such person is called the referee in case of need. It is in the option of the holder to resort to the referee in case of need or not as he may see fit." [24]

Immaterial Items. The validity of a negotiable instrument is unaffected by the omission of a date. In this event the instrument will be treated as dated at the time of issue. When an undated instrument is payable so many days after a fixed date, the true date of issue or acceptance may be inserted by the holder. If a wrong date is inserted, it will be treated as the true date when the instrument is in the hands of a holder in due course. A negotiable instrument may be antedated or postdated if this is not done for a fraudulent purpose. When it is dated, such date is deemed prima facie to be the true date.[25]

When an instrument is antedated or postdated, "the person to whom an instrument so dated is delivered acquires title thereto as of the date of delivery." (Negotiable Instruments Law, Sec. 12)

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[23] §130.
[24] §131.
[25] §13.

It is immaterial, so far as negotiability is concerned, whether an instrument bears a seal or calls for payment in a particular kind of current money. Nor is the instrument robbed of its negotiable character because it does not state that value has been given or does not specify the amount. The Negotiable Instruments Law specifies these items as non-essentials, but it expressly provides that the act does not "alter or repeal any statute requiring in certain cases the nature of the consideration to be stated in the instrument." [26]

QUESTIONS

1. Voegel executed a note in print. In an action brought against him on the note, he contended that the note was not negotiable because it was not written by hand. Was his contention sound?

2. Trelby executes a promissory note, but instead of signing it, he places certain figures where the name of the promisor usually appears. May these figures constitute a valid signature?

3. Roberts lived under an assumed name, being known as W. C. Dern. He borrowed a sum of money and executed a promissory note that he signed "W. C. Dern." Was the instrument invalid on the ground that it was improperly signed?

4. Mrs. W. T. Runkle executes the following instrument:

March 10, 19
Ninety days from date, I, Mrs W T Runkle, promise to pay Henry Morgan or order the sum of fifteen hundred dollars.

It is contended that this is not a negotiable instrument on the ground that it is not signed. Is the contention sound?

5. Berry brings an action against Grey as maker of a promissory note. He offers as evidence to support his claim a paper containing the following writing: "Due to the order of L. L. Berry Eighty Dollars on

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[26] §6.

demand. [Signed] R. S. Grey." The defendant contends that this is not a promissory note. Do you agree?

6. Is the following note negotiable?

December 1, 19

I promise to pay on January 10, 19 , provided my firm gives me a Christmas bonus, John D. Fox or order, the sum of fifty dollars.

H. H. Geer

7. Winterbotham incloses a promissory note with a letter to Peabody. In the letter he states that the promise is made upon condition that the rainfall for the year is normal. Does this condition affect the negotiability of the instrument?

8. Tilden executed an instrument in which he ordered Sills to pay to the order of W. L. Sullivan the sum of $350 out of the proceeds of the sale of the contents of Southern Pacific freight car No. X193557. In an action brought by a holder of the bill against Tilden, it was contended that the instrument was not negotiable. Do you agree with this contention?

9. Fagan orders Nixon to "Pay to Waldrip or order the sum of three hundred dollars and charge the amount to my farm account." Waldrip contends that the bill is negotiable. Is his contention sound?

10. Is the following instrument negotiable?

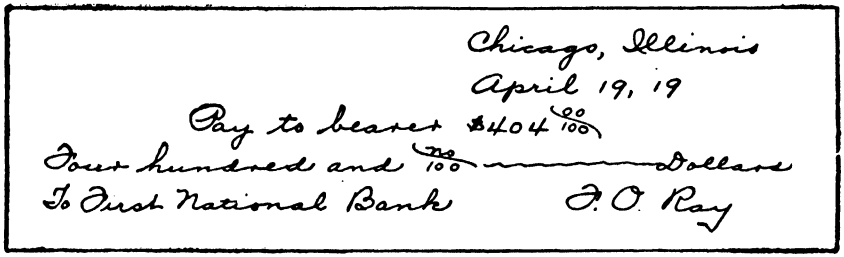
July 6, 19

Sixty days from date, I promise to pay James Orville Harrison or order, one hundred and fifty bushels of wheat.

K. N. Mood

11. A corporation executed an instrument whereby it promised to pay the sum of $1,500 or, at the option of the holder, to deliver fifteen shares of the stock of the corporation. When an action was brought by the holder of the instrument against the corporation, it was contended that the nature of the promise rendered the instrument nonnegotiable. Was this contention sound?

12. How much is the holder entitled to collect on the following instrument?


Chicago, Illinois
April 19, 19
Pay to bearer $404 00/100
Four hundred and 00/100 ——— Dollars
To First National Bank O. O. Ray

13. Ganner is the holder of a promissory note which contains provisions for (a) interest, (b) attorney's fees in case of nonpayment at maturity, and (c) the principal becoming due upon default of interest. Do any of these provisions affect the negotiability of the instrument?

14. The seller of a car of oranges drew a draft on the buyer that contained an order to pay the amount of the purchase price to the order of the First National Bank. The draft was payable thirty days after the arrival of the car at its destination. When an action was brought on the draft, it was contended that the instrument was nonnegotiable. Do you agree?

15. Conners executed a promissory note in which he promised thirty days after his marriage to pay the sum of $135 to the order of Manning. When an action was brought by the holder on the note, Conners contended that the instrument was nonnegotiable. What is your opinion?

16. A note was made payable to the order of Mayfield three days after the succeeding full moon. Was the instrument negotiable?

17. Tauber executes a promissory note payable when the ship "G. W." arrives at its home port. The ship arrives at that port. Stimson contends that the instrument is nonnegotiable. Do you agree?

18. Miller executes the following instrument: "I promise to pay I. E. Nevers or assigns the sum of one hundred dollars on demand. [Signed] G. A. Miller." When he delivers it to Nevers, the latter refuses to accept the instrument on the ground that it is nonnegotiable. Miller alleges that it is a negotiable instrument. Do you agree with the latter?

19. Peterson obtained a check payable to the order of "Lieut. R. L. Parks, Q. M., U. S. Navy." There was no such person as Parks. In a subsequent action, the court held that the check was not payable to bearer. Upon what fact did the decision of the court turn?

20. Potter executes a bill of exchange payable to Santa Claus. Annis brings an action on the bill against Potter, alleging that the instrument is payable to bearer. Is the contention of the plaintiff sound?

21. Titlow executed a promissory note payable to the order of himself. Thereafter there was litigation over the note between Titlow and the National City Bank. Was the note a bearer or an order instrument?

Part III—Liabilities of the Parties

Obligations of the Maker. The liability of the maker of a promissory note is primary. "The person primarily liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same." [1] "Absolutely" means "unconditionally," in contrast to the conditional liability of the drawer and indorsers; it does not mean that the maker cannot set up appropriate defenses. The contract of the maker is therefore to pay the note unconditionally at the time fixed and, if the place is named, at such a place.

> "It is well-settled law that the presentment of a note for payment at a place specified is not a condition precedent to an action against the maker, nor is it necessary in such action that presentment be pleaded or proved." (Federal Intermediate Credit Bank v. Epstin, 151 S. C. 67, 148 S. E. 713)

The maker in drawing an instrument admits two things. He admits, first, the existence of the payee designated in the instrument and, second, his capacity to receive and transfer the legal title to it. To illustrate, when an instrument was made payable to a married woman at common law, a bankrupt, or an infant, the maker could not deny the validity of the title transferred on the ground of lack of capacity on the part of the payee.[2] The Negotiable Instruments Law provides that "the maker of a negotiable instrument by making it engages that he will pay it according to its tenor, and admits the existence of the payee and his then capacity to indorse." [3]

Obligations of the Drawer.[4] The drawer, although the person of ultimate liability, is under a conditional liability. By executing the instrument, he undertakes to pay the amount of the bill to the holder, provided, first, the bill is duly and properly presented for acceptance or for payment, or both; and, second, in the event that acceptance or payment is refused, proper proceedings on dishonor are taken and notice thereof is given to him.

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[1] N. I. L., §192.
[2] *Hastings* v. *Dollarhide*, 24 Calif. 195.
[3] §60.
[4] §61.

> Referring to the liability of the drawer of a check, a court declared: "Said check was declared by statute to be a bill of exchange payable on demand, and in order to hold Barnes, the drawer thereof, it was necessary that the same be presented to the Morgan Bank for payment within a reasonable time, payment refused, and notice of such refusal given him." (Odle v. Barnes [Tex. Civ. A.] 2 S. W. [2d] 577)

The drawer, as in case of the maker, by executing the instrument admits the existence of the payee and his then capacity to transfer it by indorsement. Hence the drawer is estopped from denying the validity of the holder's title on such grounds. The Negotiable Instruments Law codifies these rules, as well as the rule that "the drawer may insert in the instrument an express stipulation negating or limiting his own liability to the holder."

Obligations of the Drawee. The drawee, as such, has no liability on any bill addressed to him for acceptance or payment. A refusal to accept or to pay such bill gives the holder no rights against him. The Negotiable Instruments Law expressly provides that "a bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same." [5]

> "It is settled both by statute and judicial decision that a bill of exchange of itself does not operate as an assignment, and that the drawee is not liable on the bill unless and until he accepts the same." (State v. Mix, 222 Mo. A. 426, 7 S. W. [2d] 290)

In some states it has been held that a check operates as an assignment of the funds of a depositor in the drawee bank. Other states take the view, adopted by the Negotiable Instruments Law, that "a check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check." [6]

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[5] §127.
[6] §189.

Obligations of the Acceptor. The liability of the acceptor, as in the case of the maker, is primary. He is unconditionally liable for payment of the instrument according to the tenor of his acceptance. His obligation is also similar to the maker's, in that he admits the existence of the payee and his then capacity to indorse. The liability of the acceptor differs from the maker's, in that he admits "the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the instrument." [7] This means that the acceptor is liable on an instrument to which the drawer's signature is forged. Some courts have made equitable exceptions to the rule, even after the adoption of the statutory provision stated above. Thus, if the holder has been negligent in taking the forged bill, some courts hold the acceptor is not liable.[8]

> "The acceptance of a draft does not admit the genuineness of the indorser's signature." (Nat. Union Fire Ins. Co. v. Mellon Nat. Bank, 276 Pa. 212, 119 A. 910)

An acceptor for honor, unlike the ordinary acceptor, is not primarily liable on the instrument. His contract makes him secondarily liable. "The acceptor for honor, by such acceptance, engages that he will, on the presentment, pay the bill according to the terms of his acceptance provided it shall not have been paid by the drawee, and provided also it shall have been duly presented for payment and protested for nonpayment, and notice of dishonor given to him." [9] His liability, however, extends only to the holder and the parties to the bill subsequent to the parties or party for whom he accepted the instrument.

Accommodation Parties. One may lend his credit by signing a negotiable instrument in some capacity without receiving value for so doing. He may lend his name to another by this means as a maker, drawer, acceptor, or indorser. Such a person is known as an *accommodation party.* In any case, except as noted below, an accommodation party is liable on

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[7] N. I. L., §62.
[8] *Williamsburgh Trust Co.* v. *Tum Suden,* 120 App. Div. 518, 105 N. Y. S. 335.
[9] N. I. L., §165.

the instrument to a holder for value, even though the latter knows of his position.[10]

> "If a party has signed the instrument as maker without receiving value therefor, and for the purpose of lending his name to some other person, he is an accommodation maker, and is liable on the instrument to a holder for value notwithstanding such holder knew him to be only an accommodation party." (Crothers v. Nat. Bank of Chesapeake City, 158 Md. 587, 149 A. 270)

An accommodation indorser frequently places his name outside of the usual order of indorsement. When the accommodated party is the maker or the drawer, this occurs, and hence the accommodation party's name appears on the instrument before that of the payee. When a stranger, or, in other words, one who is not otherwise a party to the instrument, places his name before that of the payee, the writing is known as an irregular or anomalous indorsement.

There are conflicting decisions in respect to the liability of an irregular or anomalous indorser. Some courts hold such a party to be an indorser, whereas others hold him to be a guarantor, and still others hold him to be a joint maker or drawer. The Negotiable Instruments Law adopts the rule that "where a person, not otherwise a party to an instrument, places thereon his signature in blank before delivery, he is liable as indorser in accordance with the following rules: (1) If the instrument is payable to the order of a third person, he is liable to the payee and to all subsequent parties; (2) if the instrument is payable to the order of the maker or drawer, or is payable to bearer, he is liable to all parties subsequent to the maker or drawer; (3) if he signs for the accommodation of the payee, he is liable to all parties subsequent to the payee." [11]

QUESTIONS

1. Earl Schiller executed and delivered a promissory note for $60 payable to Blazer thirty days after date. The payee transferred the instrument by indorsement to the Traders' National Bank. In an action on the note brought by the bank, Schiller contended that he had a secondary liability. Do you agree?

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[10] N. I. L., §169.
[11] §64.

2. Bartholemew, to whom a note has been negotiated by the payee, brings action on the instrument against the maker. The latter claims that Bartholemew does not have a valid title on the ground that the payee is an infant. Is his contention sound?

3. A holder brings an action on a bill of exchange against the drawer. The latter proves that the holder did not properly present the instrument for payment. Is this fact a valid defense?

4. Hillsinger executed and delivered to Tallant a draft drawn on Miller. The draft was presented properly for payment, which was refused. Tallant, without giving notice of dishonor, brought an action to recover the amount of the draft from Hillsinger. Was he entitled to judgment?

5. Lichen, to whom a draft has been negotiated by the payee, is suing the drawer. The latter claims that Lichen does not have a valid title on the ground that the payee was insane. Is Lichen entitled to judgment?

6. A drawer of a draft stipulates in the instrument that the holder cannot resort to him for payment in the event of nonpayment by the drawee. Is this provision valid?

7. Willis issued a draft to Ferber. The draft was drawn on the American Tile Company. When payment was refused, Ferber brought an action on the draft against the drawee. Was he entitled to judgment?

8. Eldredge, the payee of a draft payable thirty days after sight, presents the instrument to the drawee for acceptance. The latter refuses to accept, and Eldredge brings an action against him on the instrument. Is he entitled to judgment?

9. A bank refused to honor a check presented for payment. In an action brought by the holder against the bank, it was proved that the drawer had sufficient funds to pay the check on deposit with the drawee bank. The holder contended that the check operated as an assignment of the funds to the credit of the drawer. Do you agree?

10. The National Bank of Commerce brought an action against Umbright, the acceptor of a draft. It was contended by Umbright that his liability for payment of the instrument was the same as the liability of the drawer thereof. Was his contention sound?

11. A holder brings an action on a draft against the acceptor. The latter contends that he is not liable on the instrument on the ground that the signature of the drawer was forged. Is his contention sound?

12. A bill of exchange is indorsed by Boltz, Linner, and Gurney successively. The instrument is accepted by Pershing for the honor of Linner. What is Pershing's liability to Boltz? to Gurney?

13. A holder is bringing action on a note against an accommodation indorser. The latter maintains that he has no liability on the ground that the holder had knowledge of the capacity in which he signed. Is his contention sound?

14. Lauren executes a bill of exchange payable to himself and indorses it to Graham. Before the instrument is delivered to Graham, however, Paulisen places his signature thereon in blank. What is Paulisen's liability, if any, to Lauren? to Graham?

Part IV—Transfer

By Assignment. Nonnegotiable instruments may be transferred only by assignment. Although one usually transfers a negotiable instrument by negotiation, he may also assign it. In such a case, however, the transferee gets only the rights of an assignee. An assignment may be made in one of two ways, by law or by act of the parties.

By Law. An assignment by operation of law occurs when by virtue of the law one person is vested with the title of another. For example, when the holder of a negotiable instrument becomes a bankrupt or dies, the title to the instrument vests respectively in the trustee or the executor.[1]

> "The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of filing of the petition in bankruptcy or of the original petition proposing an arrangement or plan under this title." (United States Code, 1940, Title 11, Bankruptcy, Sec. 110)

By Act of Parties. A negotiable instrument is considered as having been assigned "where the holder of an instrument payable to his order transfers it for value without indorsing it." [2] In this event, however, the transferee has the right to require that the transferor indorse the instrument. During the period between the transfer and the indorsement, if obtained, the transferee has only the rights of an assignee. In other words, negotiation, as distinguished from assignment, is effective only as of the time when the indorsement is made. This fact is important in determining whether the transferee is a holder in due course.

By Negotiation. Only negotiable instruments may be transferred by negotiation. A transfer by this method may be accomplished in one of two ways: by delivery or by indorsement and delivery, according to the nature of the instrument.

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[1] *Rand* v. *Hubbard*, 4 Metc. (Mass.) 256.
[2] N. I. L., §49.

By Delivery. Any instrument payable to bearer may be negotiated by merely delivering the same to the transferee. This is true whether the instrument expressly states that it is payable to bearer, or whether it is payable to bearer by virtue of some rule of law. As a matter of practice, however, the holder is usually required by the transferee to indorse such instruments.

> "A negotiable instrument payable to a named person or bearer may be transferred by delivery alone." (A. J. Colson & Sons v. Ellis, 40 Ga. A. 768, 151 S. E. 654)

The Negotiable Instruments Law provides that a negotiable instrument payable to bearer and indorsed specially [3] may be further negotiated by delivery, although "the person indorsing specially is liable as indorser to only such holders as make title through his indorsement." [4] This provision has caused considerable criticism on the ground of repugnancy between it and the provision which states that negotiation by delivery is permitted when the instrument is payable to bearer.[5] By the terms of Section 9 of this act, an order instrument is payable to bearer only when the last or only indorsement is in blank. Yet by the terms of Section 40, stated above, an order instrument indorsed in blank and later indorsed specially may be negotiated by delivery. The effect of the provision seems to be that an order instrument once made payable to bearer remains so in favor of all subsequent parties.

> In Illinois Sec. 40 is limited to instruments "originally payable to or indorsed specially to bearer." In West Virgina it has been repealed. (5 Uniform Laws Annotated, page 484)

By Indorsement and Delivery. An instrument payable to order may only be negotiated by indorsement and delivery by the holder. The indorsement must be written upon the instrument or upon a paper attached thereto. The latter is known as an *allonge*. An indorsement requires no particular form of words. For example, it may consist of the signature of

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[3] See "Special Indorsement," p. 311.
[4] N. I. L., §40.
[5] N. I. L., §30.

the indorser alone.[6] It must, however, be indorsed by the person to whom it is payable. If there is more than one payee or indorsee, all must indorse. This rule does not apply, however, when they are partners, or when one is authorized to act for the others, if he signs for all.[7] "Where an instrument is drawn or indorsed to a person as 'Cashier' or another fiscal officer of a bank or corporation, it is deemed prima facie to be payable to the bank or corporation of which he is such officer, and may be negotiated by either the indorsement of the bank or corporation, or the indorsement of the officer." [8] A part of an instrument cannot be indorsed to one person, nor can the entire instrument be indorsed in parts to persons severally. If the instrument has been partly paid, however, the residue may be transferred by indorsement.[9]

Kinds of Indorsements. An indorsement may be made in any of several forms. It may be (1) special, (2) blank, (3) restrictive, (4) qualified, or (5) conditional.

Special. A special indorsement is one which specifies the person to whom, or to whose order, the instrument is to be paid. The Negotiable Instruments Law prescribes that "the indorsement of such indorsee is necessary to the further negotiation of the instrument." [10] This is true, however, only as to the special indorser, as it has been noted above that Section 40 permits negotiation of a bearer instrument by delivery, although the last indorsement is special.

> A note contained the following indorsement: "Oct. 27, 1930, I hereby assign the within note and mortgage to Baldwin-Heckes Company (Signed) J. W. Curl." This was a special indorsement. (Baldwin-Heckes Co. v. Kammerlohr, 123 Nebr. 317, 242 N. W. 661)

Blank. A blank indorsement is one in which the name of the indorsee does not appear. This is the most common form of indorsement, usually consisting merely of the name of the

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[6] N. I. L., §31.
[7] N. I. L., §41.
[8] N. I. L., §42.
[9] N. I. L., §32.
[10] §34.

indorser. As indicated above, the effect of this kind of indorsement is to make the instrument payable to bearer. The holder is entitled to complete the indorsement by writing over the name of the indorser that it is payable to a particular person, thus making it a special indorsement.

> "The holder may convert a blank indorsement into a special indorsement by writing over the signature of the indorser in blank any contract consistent with the character of the indorsement." (Negotiable Instruments Law, Sec. 35)

Restrictive. A restrictive indorsement is one which restrains the general negotiability of the instrument. To illustrate, if the payee indorsement directs that the instrument be paid to "Alex White only," the latter can present it for payment but cannot sell or otherwise transfer it.[11] In such cases it is a question whether the nature of the indorsement shows an intent of the indorser to restrict further negotiation. "Pay to Alex White" would probably be deemed not restrictive, because courts are not inclined to hold an indorsement to be restrictive unless the intent is clearly shown.[12] "Pay to any bank or banker" is not considered restrictive by some courts but is by other courts and under some statutes.[13] The Negotiable Instruments Law states that a "restrictive indorsement is one which (1) prohibits the further negotiation of the instrument, or (2) constitutes the indorsee the agent of the indorser, or (3) vests the title in the indorsee in trust for or to the use of some other person." [14]

> The First National Bank of Idaho forwarded to the First National Bank of Vale, Oregon, certain checks and certificates of indebtedness indorsed "for collection only." The indorsements were restrictive indorsements. (Nyssa-Arcadia Drainage Dist. v. First Nat. Bank, 3 F. [2d] 648)

The indorsee who takes a restrictive indorsement can present the instrument for payment, sue all previous parties, except his indorser, and, when the indorsement permits, trans-

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[11] *Power* v. *Finnie*, 4 Call (Va.) 411.
[12] In *Edie & Laird* v. *East India Co.*, 1 Wm. Bla. 295, Mansfield, C. J., it was declared that "or order" is implied.
[13] Bank Collection Code, §4.
[14] §36.

fer his rights. The common-law rule is that a subsequent holder takes the instrument subject to the rights of the one making the restrictive indorsement. This rule has been codified by the Negotiable Instruments Law, which provides that "all subsequent indorsees acquire only the title of the first indorsee under the restrictive indorsement." [15] Thus, when a draft indorsed "Pay Jay Cooke & Co. or order, on account of Blaine, Gould & Short," was negotiated by a general indorsement of Jay Cooke & Co. to Bourne & Co., it was held that Bourne & Co., after collection, held the money in trust for Blaine, Gould & Short.[16]

> Statutes, such as the Bank Collection Code, may greatly affect the rights of the parties under restrictive indorsements. See statutes of Idaho, Illinois, Indiana, Kentucky, Maryland, Michigan, Missouri, Nebraska, New Jersey, New Mexico, New York, Oregon, Pennsylvania, South Carolina, Washington, West Virginia, Wisconsin, and Wyoming.

Qualified. A qualified indorsement is one which limits the liability of the indorser from that of the ordinary indorser. This is usually done by use of the term *without recourse,* but any words of similar import which indicate clearly an intention to restrain liability are sufficient. A qualified indorsement, unlike a restrictive indorsement, does not impair negotiability, although it "constitutes the indorser a mere assignor of the title to the instrument." [17]

> "The effect of a qualifying indorsement is merely to limit the liability of the indorser who makes it." (Ross v. Title Guarantee & Trust Co., 136 Calif. A. 393, 29 P. [2d] 236)

The ordinary qualified indorsement only relieves the indorser from liability to pay the amount of the instrument in case of dishonor in such instances as when the person primarily liable arbitrarily refuses, neglects, or is unable to pay. It does not relieve him from his collateral warranties in respect to such facts as the genuineness of the instrument or

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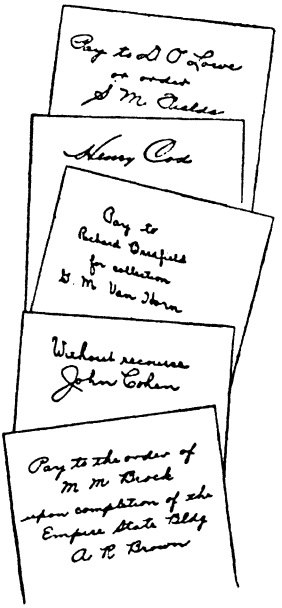
[15] §37.
[16] *Blaine* v. *Bourne,* 11 R. I. 119.
[17] N. I. L., §38.



INDORSEMENTS

the capacity of prior parties to contract.[18] To avoid liability under these circumstances, the indorser must also clearly qualify his liability in respect to warranties in some way such as indorsing "Without recourse and without warranties."

> The Blanks Motor Company transferred a note to the Commercial Credit Company by an indorsement "without recourse." The maker of the note was a minor who refused to pay the instrument. Notwithstanding the qualified indorsement, the Blanks Motor Company was liable on its warranty as to the capacity of the maker. (Commercial Credit Co. v. Blanks Motor Co., 174 Ark. 274, 294 S. W. 999)

Conditional. A conditional indorsement is one which expresses some contingency upon which the indorser's liability is to begin or to cease. It does not ordinarily affect the negotiable character of the instrument, but it gives notice to subsequent indorsees that such indorsement is not binding until or after, as the case may be, such condition has been fulfilled. The Negotiable Instruments Law adopts this rule, stating that

[18] See p. 316.

"where an indorsement is conditional, a party required to pay the instrument may disregard the condition and make payment to the indorsee or his transferee, whether the condition has been fulfilled or not. But any person to whom an instrument so indorsed is negotiated will hold the same, or the proceeds thereof, subject to the rights of the person indorsing conditionally." [19] Under these rules, when there is a conditional indorsement and the holder collects on the note but the condition does not happen, the indorser may not hold the maker for wrongful payment, although he may recover from the holder who made the collection.

Obligations of the Indorser. A general indorsement, in addition to being a transfer of the instrument, is also an agreement on the part of the indorser to pay the instrument in case it is dishonored. His liability for such payment, however, is conditional. He agrees to pay provided, first, the instrument is properly presented for acceptance or payment, or both; and, second, due notice of dishonor is given him. In this respect, the liability of the general indorser is identical with that of the drawer.

> "Even though the maker of a note be insolvent, and the indorser have knowledge of the financial condition of the maker, the plaintiff is not relieved of the requirement to present the note for payment in accordance with its terms and if dishonored to give notice thereof to the indorser in order to hold him." (Lane Cotton Mills Co. v. Kohler, 186 La. 469, 172 S. 530)

The indorsement also carries another undertaking on the part of the indorser.[20] It is "a collateral contract of warranty by which, under Section 66 of the Negotiable Instruments Law, which is intended to be a codification of the existing law, he warrants that the instrument is genuine and in all respects what it purports to be; that he has a good title to it; that all prior parties had capacity to contract; that the instrument at the time of his indorsement is valid and subsisting." [21]

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[19] §39.

[20] A qualified indorser ordinarily has the same collateral undertakings as one who transfers an instrument by delivery. *See* page 316.

[21] *Mackintosh* v. *Gibbs*, 79 N. J. L. 40, 74 A. 708.

J. W. Crafton by general indorsement transferred a note to the Wachovia Bank & Trust Company. The note, having been given for a gambling debt, was void under a statute. Crafton was liable on his warranty that the instrument was a valid and subsisting obligation. (Wachovia Bank & Trust Co. v. Crafton, 181 N. C. 404, 107 S. E. 316)

If one places his indorsement on an instrument which may be negotiated by delivery, he thereby assumes all the liabilities of an indorser. Indorsers, in respect to each other, are liable prima facie in the order of their indorsements, although it may be shown that they have agreed otherwise. The Negotiable Instruments Law also states that "joint payees or joint indorsees who indorse are deemed to indorse jointly and severally." [22]

Obligations of the Transferor by Delivery. One who transfers by delivery an instrument payable to bearer makes no contract of indemnity. In other words, he assumes no liability for payment in case the principal obligor merely refuses to accept or pay the instrument or is financially unable to do so. Thus, when a holder of an order note indorsed in blank transferred it by delivery to another, the latter was not allowed to exact payment from him when the instrument was not paid. The court said: "By receiving and passing the note while under a blank indorsement, and without putting his name on it, he assumed no responsibility in relation to it. The moment he parted with it he became as much a stranger to it as if he had never held it. Had the party to whom he passed it wished him to assume any responsibility in relation to it, he should have required his indorsement upon it." [23] In this respect, the transferor by delivery is in the same position as the indorser without recourse.

C. Gresham indorsed "without recourse" to J. C. Medlin certain notes made by F. S. Miles and wife. The makers were unable to pay the instruments at maturity. Medlin had no recourse to Gresham. (Medlin v. Miles, 201 N. C. 683, 161 S. E. 207)

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[22] §68.
[23] *Roberts* v. *Haskell*, 20 Ill. 59.

One who negotiates an instrument by delivery or by qualified indorsement, however, is not entirely free from responsibility. In either case, the party ordinarily makes a collateral contract upon which he may be held. He warrants "(1) that the instrument is genuine and in all respects what it purports to be; (2) that he has a good title to it; (3) that all prior parties had capacity to contract; (4) that he has no knowledge of any fact which would impair the validity of the instrument or render it valueless." [24] The Negotiable Instruments Law gives the benefit of such warranties only to the immediate transferee when the negotiation is by delivery.

QUESTIONS

1. Clarke executed and delivered a promissory note to Hooper, who died soon thereafter. The executor of Hooper's estate indorsed and delivered the instrument to Ralph Kerns. When Kerns brought an action on the note against Clarke, it was contended that the instrument had not been properly negotiated to Kerns. Do you agree?

2. Hayward, by fraud, was induced to execute and deliver a note for $500, payable to Smith, the defrauder. The note was purchased before maturity in good faith by Joseph Horn, to whom Smith transferred the instrument without indorsing it. Horn brought an action on the note against Hayward. Was he entitled to judgment?

3. Kirven became the holder of a draft payable to his order. Thereafter he delivered the instrument without indorsement to Lanier, who paid value therefor. Subsequently Lanier brought an action to compel Kirven to indorse the draft. Was Lanier entitled to judgment?

4. McNeil was the holder of a note executed by Johnson and payable to bearer. He transferred the instrument by delivery to Ernest Owens. When Owens brought an action on the note against Johnson, it was contended that the note had not been properly negotiated. Was this contention sound?

5. An instrument is made payable to the order of Carlow who indorses it in blank to Woodruff. The latter indorses it specially to Banster. May the instrument now be negotiated by delivery?

6. Hergel is the payee of a note for $100. He indorses part of the amount to Gorman. The latter brings an action for the amount against the promisor. Is he entitled to judgment?

7. Dotson executed and delivered a draft for $13,762, payable to E. J. Kirkpatrick, William McDonald, and Sam Broyles. Thereafter

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[24] N. I. L., §65.

McDonald indorsed the instrument to Grinnell. When Grinnell brought an action on the draft against Dotson, it was contended that the instrument had not been properly negotiated. Was this contention sound?

8. C. E. Spies executed and delivered a note for $187, payable to Sinclair Creighton, Cashier of the Southern State Bank. The instrument was transferred by an indorsement of the bank to Tuttle. When an action was brought on the note by Tuttle against Spies, it was contended that the instrument had not been properly negotiated. Do you agree?

9. Classify the following indorsements:

(a) John Doe
(b) Pay to Richard Roe, John Doe
(c) Pay to Richard Roe only, John Doe
(d) Pay to Richard Roe if he arrives in New York January 10, 19—, John Doe
(e) Without recourse, John Doe

10. Mizner indorses a note: "Pay to Gahagen for collection." Gahagen gives the note to Storms in part payment of an automobile. Storms transfers the note for value to McVete. Is the latter entitled to collect the amount of the note?

11. Cameron, who is the payee of a note, indorses the instrument without recourse to Hobbs. Does this indorsement impair the negotiability of the instrument?

12. Brisbane indorses a note: "Pay to Coffman upon completion of the rectory." Coffman negotiates the instrument to Laybourne to whom the maker pays the amount due. The rectory is not completed. Brisbane brings an action against Laybourne to recover the amount collected on the instrument. Is he entitled to judgment?

13. Dunton, who is the payee of a promissory note, indorses it to Irving. How does the former's liability for payment compare with that of the maker of a note? of the drawer of a bill of exchange?

14. McCall, Sargent, and Torrence are successive indorsers of an instrument. What is their liability in respect to each other?

15. A draft executed by the Fargo Cereal Company was indorsed by the payee to Fred Ettelson and Cecil Maunz. The indorsees both indorsed the instrument to Coopersmith. After proper presentment for payment and due notice of dishonor, Coopersmith brought an action to recover the amount of the draft from Maunz. Was he entitled to judgment?

16. Dudley is the holder of a note payable to bearer. He transfers it to Stowall by delivery. The maker is unable to pay the instrument when due. Is Stowall entitled to exact payment from Dudley?

17. Allen, the indorsee of a note, negotiated the instrument to Cherry by qualified indorsement. Thereafter the note was indorsed by Cherry to Milton. Payment of the instrument was refused on the ground of forgery. Milton sought to recover the amount of the note from Allen. Was Milton entitled to do so?

Part V—Presentment

Acceptance. An acceptance of a bill of exchange is the assent of the drawee to the order of the drawer, indicated in an appropriate manner. In the absence of statute, acceptance may be made orally, but the Negotiable Instruments Law prescribes that it "must be in writing and signed by the drawee." [1] An acceptance, however, need not be in any particular form of words, so long as the words indicate an intent to accept. "Any words written by the drawee on a bill, not putting a direct negative upon its request, as 'accepted,' 'presented,' 'seen,' the day of the month, or a direction to a third person to pay it, are prima facie a complete acceptance, by the law merchant." [2] The signature of the drawee alone is held to be a valid acceptance.

> M. E. Temple signed merely his name to a bill drawn on him by M. J. Temple. When he was sued as an acceptor, the court declared: "We are of the opinion that under G. L. c. 107, Sec. 155, a drawee may be charged as an acceptor although he writes merely his name upon the bill." (Lawless v. Temple, 254 Mass. 395, 150 N. E. 176)

An acceptance is usually placed on the instrument, but it may be on a separate paper, as a telegram or letter. Thus, when a drawee, in answer to a request from a bank whether he would honor a certain draft drawn by J. A. McMillan for $250, wired, "Will pay McMillan's draft on me," his telegram was an acceptance.[3] The Negotiable Instruments Law, however, provides that "the holder of a bill presenting the same for acceptance may require that the acceptance be written on the bill, and, if such request is refused, may treat the bill as dishonored." [4] It also provides that an acceptor is bound by an acceptance on a separate paper only to persons to whom it has been shown and who, relying thereon, give value for the bill.

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[1] §132.
[2] *Spear* v. *Pratt*, 2 Hill (N. Y.), 582.
[3] *State Bank of Beaver County* v. *Bradstreet*, 89 Neb. 186, 130 N. W. 1038.
[4] §133.

"Where an acceptance is written on a paper other than the bill itself, it does not bind the acceptor except in favor of a person to whom it is shown and who, on the faith thereof, receives the bill for value." (Negotiable Instruments Law, Sec. 134)

A written agreement to accept is treated as an acceptance in favor of one who, relying thereon, gives value for the bill. Thus, if a packing company writes to a shipper of turkeys in Texas, promising to accept drafts drawn by the shipper for specified amounts, a bank that is shown the letter and in reliance thereon takes the drafts may hold the firm as an acceptor.[5] The agreement to accept may refer to either existing drafts or drafts not yet drawn. In the latter case the draft must be drawn strictly in accordance with the agreement to accept. It should be noted that the Negotiable Instruments Law does not require sight of the agreement to accept, as in the case of an acceptance on a separate paper.[6]

Kinds of Acceptances. An acceptance may be either general or qualified. A *general* acceptance is one which assents without qualification to the order of the drawer. A *qualified* acceptance is one which expressly varies the effect of the bill as drawn. An acceptance is qualified when it changes the time of payment, changes the place of payment, agrees to pay only a part of the amount ordered, or makes the acceptor's liability dependent upon the fulfillment of a condition. Although the Negotiable Instruments Law provides that an agreement to pay only at a particular place is a qualified acceptance, it also provides that "an acceptance to pay at a particular place is a general acceptance, unless it expressly states that the bill is to be paid there only and not elsewhere." [7]

A drawee accepted a draft in the following language: "Recd. from Milwaukee Corrug't. Co. an order from Frank Anderson to pay their note of $409 as soon as proceeds of sale of hardware is available, which I will do. (Signed) E. L. Traylor." This was a qualified acceptance. (Milwaukee Corrugating Co. v. Traylor, 95 Kans. 562, 148 P. 653)

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[5] *Belton Nat. Bank* v. *Armour & Co.*, 11 F. (2d) 929.
[6] §§134 and 135.
[7] §140; see also §141.

The holder of a bill is entitled to a general acceptance and may refuse to take a qualified acceptance. In the event that an unqualified acceptance cannot be obtained, he may treat the bill as dishonored by nonacceptance. He may elect, however, to take a qualified acceptance. In such case the drawer and indorsers are released from liability, unless they subsequently assent thereto or had previously expressly or impliedly authorized the taking of a qualified acceptance. The holder who takes a qualified acceptance should immediately notify the drawer and indorsers. When the drawer or an indorser is notified, "he must, within a reasonable time, express his dissent to the holder, or he will be deemed to have assented thereto." [8]

Presentment for Acceptance. Certain drafts must be presented for acceptance in order to charge the drawer and the indorsers. One type of bill that must be presented for acceptance is one the presentment of which is necessary in order to fix the date of maturity, as where it is payable "thirty days after sight." The Negotiable Instruments Law further prescribes that presentment for acceptance is necessary, first, when there is a stipulation in the instrument to that effect and, second, when the bill orders payment at some place other than the place of business or the residence of the drawee.[9] Bills of these classes must be presented for acceptance or negotiated within a reasonable time. The failure to do one or the other, unless excused, discharges the drawer and indorsers from liability.

> Presentment for acceptance is excused "(1) Where the drawee is dead, or has absconded, or is a fictitious person or a person not having capacity to contract by bill; (2) Where, after the exercise of reasonable diligence, presentment cannot be made; (3) Where, although presentment has been irregular, acceptance has been refused on some other ground." (Negotiable Instruments Law, Sec. 148)

Although not all drafts are required to be presented for acceptance, the holder of any draft may present it if he desires.

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[8] N. I. L., §142.
[9] §143.

Thus a draft payable on demand or at a fixed time may be presented for acceptance, although this is not necessary. In such a case, "it is to the owner's interest that the bill should be so accepted, as only by accepting it does the drawee become bound to pay it; and until such acceptance the owner has for his debtor only the drawer, and the step is one which a prudent man or business, ordinarily careful of its own interests, would take for its protection." [10]

Sufficiency of Presentment for Acceptance. Presentment for acceptance must be made to the drawee personally or to one authorized by him to accept or refuse acceptance. If the drawee is dead, the holder may present the instrument to the personal representative. If the drawee has assigned his property for the benefit of creditors or has been adjudicated a bankrupt, presentment may be made to the assignee or trustee. Presentment must be made to all persons named as drawees, if they are not partners, except when one has been authorized by the others to accept or refuse acceptance for them. These rules have been codified by the Negotiable Instruments Law.[11]

Upon presentment for acceptance, the holder should exhibit the draft. Presentment for acceptance should be made at the drawee's place of business or residence, if it is known. If the place of business and the residence are in different parts of the same city or in different cities, presentment may be made at either place.

> "Where the holder of a bill payable elsewhere than at the place of business or the residence of the drawee has not time with the exercise of reasonable diligence to present the bill for acceptance before presenting it for payment on day it falls due, the delay caused by presenting the bill for acceptance before presenting it for payment is excused and does not discharge the drawer and indorsers." (Negotiable Instruments Law, Sec. 147)

When necessary, presentment for acceptance should be made by the holder, or in his behalf, within a reasonable time

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[10] *N. Y. Nat'l Park Bank* v. *Saitta*, 127 App. Div. 624, 111 N. Y. S. 927.

[11] §145.

before the draft is due, unless it is negotiated during such period. What constitutes a reasonable time will depend upon the circumstances of each case. The Negotiable Instruments Law states that "in determining what is a 'reasonable time' or an 'unreasonable time,' regard is to be had to the nature of the instrument, the usage of trade or business (if any) with respect to such instruments, and the facts of the particular case." [12]

> "Except as herein otherwise provided, the holder of a bill which is required by the next preceding section to be presented for acceptance must either present it for acceptance or negotiate it within a reasonable time. If he fails to do so, the drawer and all indorsers are discharged." (Negotiable Instruments Law, Sec. 144)

Presentment for acceptance may be made on any day, except Sunday or a holiday. If Saturday is not a holiday, presentment may be made before twelve o'clock noon on that day. If it is not presented at the drawee's residence, the instrument must be presented during business hours. If presentment is made at the residence of the drawee, it must be made during hours that are reasonable for that particular community. For example, presentment is not proper if made at a residence at an hour when the families in the community ordinarily have retired for the night.[13]

Presentment for Payment. Ordinarily a negotiable instrument must be presented for payment in order to charge the drawer of a draft or the indorsers of a draft or a note. Thus, if presentment for payment is not waived or excused, the holder's failure to present a note to the maker for payment will discharge the indorsers from liability.[14] The rule does not apply, however, when a draft has been dishonored by nonacceptance.[15]

> A failure to present a check for payment at any time discharges the drawer of a check, as in case of the drawer of a bill. (Rodriguez v. Hardouin, 15 La. A. 112, 131 S. 593)

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[12] §193.
[13] *Dana* v. *Sawyer*, 22 Me. 244.
[14] *Merchants' Nat. Bank v. Bentel*, 166 Calif. 473, 137 P. 25.
[15] N. I. L., §151.

Presentment for payment is not necessary to charge a person primarily liable on the instrument, such as the maker or acceptor. In such a case, however, the Negotiable Instruments Law provides that "if the instrument is, by its terms, payable at a special place, and he [the maker or acceptor] is able and willing to pay it there at maturity, such ability and willingness are equivalent to a tender of payment upon his part." [16] Thus, when a note was payable at the Arlington National Bank and the maker was able and willing to meet the obligation at the time and the place fixed in the instrument, the holder could not collect interest from such time or court costs.[17]

> F. J. Tuttle, when sued as maker of a note, failed to defeat the action on the ground that the instrument had not been presented to him for payment. The court stated: "Section 70 of the Uniform Negotiable Instruments Act provides that presentment for payment is not necessary to charge the person primarily liable. The defendant was primarily liable, hence no presentment was necessary." (Armour Fertilizer Works v. Tuttle, 126 Me. 423, 139 A. 225)

In some instances presentment for payment is not necessary to charge the drawer or indorsers. These are, first, where presentment for payment is impossible by exercising reasonable diligence; second, where the draft is drawn on a fictitious drawee; and, third, where the drawer or indorser has expressly or impliedly waived presentment. These rules have been codified by the Negotiable Instruments Law.[18] This act also expressly specifies that it is not necessary to present an instrument for payment in order to charge the drawer "where he has no right to expect or require that the drawee or acceptor will pay the instrument." [19] For example, presentment of a check for payment is not necessary to charge the drawer who has stopped payment of the check.[20] Another provision makes presentment unnecessary to charge an indorser when "the instrument was made or accepted for his accommodation, and he has no reason to expect that the instru-

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[16] §70.
[17] *Maddock* v. *McDonald*, 111 Oreg. 448, 227 P. 463.
[18] §82.
[19] §79.
[20] *Usher* v. *A. I. Tucker Co.*, 217 Mass. 441, 105 N. E. 360.

ment will be paid if presented." [21] Thus, if a borrower indorses a note signed by a friend as an accommodation so that he can obtain a loan, the holder of the note need not present the note to the friend for payment in order to charge the borrower as an indorser.[22]

Sufficiency of Presentment for Payment. A sufficient presentment for payment consists of a presentment by the holder, or one authorized by him to receive payment, to the proper parties at the proper time and place.

Presentment for payment must be made to the party primarily liable. If he is inaccessible or absent, presentment must be made to any person found at the place where the instrument is presented. In the event of the death of the one liable on the instrument, and no place of payment is specified, presentment must be made to his personal representative, if there is any and he can be found with reasonable diligence.[23] When there are several persons primarily liable, presentment must be made to all, except, first, when they are partners or, second, when a place of payment is specified. If they are partners and no place of payment is specified, presentment may be made to any one of them. This is true even though the firm has been dissolved.[24] Unless its production is waived or is impossible because of its destruction or loss, the instrument must be exhibited at the time payment is demanded and must be surrendered to the party paying it.

> Holding that a demand for payment made over the telephone was insufficient, the court said: "A valid presentment, as hitherto pointed out, consists of something more than mere demand. It requires personal attendance at the place of demand with the note, in readiness to exhibit it if required, and to receive payment and surrender it if the debtor is willing to pay." (Gilpin v. Savage, 201 N. Y. 167, 94 N. E. 656)

The proper place for presentment for payment depends upon the terms of the instrument or other circumstances.

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[21] §80.
[22] *Bergen* v. *Trimble*, 130 Md. 559, 101 A. 137.
[23] N. I. L., §76.
[24] N. I. L., §§77, 78.

Presentment for payment is properly made at the place specified in the instrument. If the place is not specified, presentment is properly made at the address of the person responsible for payment, if it appears in the instrument. In the absence of such a specified place or address, presentment is properly made at the usual place of business or the residence of the person from whom payment is to be demanded. The Negotiable Instruments Law adopts these rules and adds that in any other case proper presentment for payment is made if the instrument is presented to the person who is to make payment wherever he can be found, or if it is presented at his last known place of business or residence.[25]

> A note was payable to the order of Olaf Grondahl "at his store in Fargo, North Dakota." Presentment for payment at the specified store was made at the proper place. (Nelson v. Grondahl, 13 N. D. 363, 100 N. W. 1093)

The proper time for presentment for payment varies with the nature and terms of the instrument. Promissory notes payable on demand must be presented within a reasonable time after issue. On the other hand, bills of exchange payable on demand must be presented only within a reasonable time after the last negotiation.[26] In the case of a check, this rule applies to indorsers, but not to the drawer. The Negotiable Instruments Law provides that "a check must be presented for payment within a reasonable time after its issue, or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay." [27]

> Holding that seven days was an unreasonable delay, a court said: "As between the holder of a check and an indorser, unreasonably delay in presentment for payment . . . will discharge the indorser from his liability without regard to whether such delay did or did not occasion loss to the holder." (Swift & Co. v. Miller, 62 Ind. A. 312, 113 N. E. 447)

An instrument not payable on demand must ordinarily be presented for payment on the day it falls due and during rea-

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[25] §73.
[26] N. I. L., §71.
[27] §186.

sonable hours, as in the case of presentment for acceptance. In determining the date of maturity of an instrument payable at a specified period after sight, after the happening of an event, or after the date of the instrument, one excludes the starting day and includes the day of payment. Thus an instrument dated July 3, 19—, and payable thirty days from date, is due on August 2, 19—, unless that day is a holiday or Sunday, in which case it is payable on the following business day.[28] At one time three days of grace were allowed the debtor in which to obtain funds for payment. This rule is expressly abolished by the Negotiable Instruments Law, although the latter provides that "instruments falling due on Saturday are to be presented for payment on the next succeeding business day, except that instruments payable on demand may, at the option of the holder, be presented for payment before twelve o'clock noon on Saturday when that entire day is not a holiday." [29]

> The holder of a note presented the instrument for payment before the day on which it fell due. Holding that the presentment was improper and that the indorser was discharged, the court declared: "A presentment on the day before the note falls due is premature and insufficient to charge the indorser." (Long v. Alder, 169 Tenn. 422, 88 S. W. [2d] 802)

Failure to present an instrument for payment at the proper time will be excused when the delay is caused by circumstances beyond the control of the holder. It must not, however, be caused by his misconduct, negligence, or fault. To illustrate, mere inconvenience arising from inclement weather is not a valid excuse for delay.[30] When the circumstances which excuse delay are removed, presentment must be made thereafter within a reasonable time.

QUESTIONS

1. L. E. Lawren drew a draft on Charles Sumner. When the instrument was presented for acceptance, Sumner wrote his name and the date thereon. The draft was thereafter negotiated to Templeton,

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[28] N. I. L., §§86 and 194.
[29] §85.
[30] *MacDonald* v. *Mosher*, 23 Ill. A. 206.

who brought an action to recover from Sumner as an acceptor. Sumner contended that he had not accepted the instrument. Do you agree with this contention?

2. Warren was the holder of a draft that he presented for acceptance. The drawee refused to place his acceptance on the instrument, but he was willing to write an acceptance in a letter addressed to Warren. Thereupon Warren notified the drawer that the instrument had been dishonored and brought an action to recover the amount of the draft. Was he entitled to do this?

3. J. O. Macon by letter accepted a draft drawn on him. McFarlan heard about the acceptance and purchased the instrument. Thereafter he brought an action against Macon as an acceptor. Was McFarlan entitled to judgment?

4. Addison presented a draft for acceptance. The drawee, Bass, wrote an acceptance on an old piece of wrapping paper. When shown the acceptance by Bass, Henson believed it to be a forgery, but he nevertheless purchased the draft. Thereafter Henson brought an action against Bass as an acceptor. Was he entitled to judgment?

5. Knight writes Pritham that he will accept a draft drawn on him for $500. Pritham draws an order on Knight for that amount payable to McHenry. The latter sells the instrument to Nilsson who knows of the agreement to accept but does not see the letter. Nilsson brings an action against Knight as an acceptor. Is he entitled to judgment?

6. A bill of exchange is presented to a drawee who indicates on the instrument that he will pay it only at the First National Bank in his city. Has he made a general or a qualified acceptance?

7. Allen Clarke was the holder of a draft that he presented to Morton, the drawee, for acceptance. Morton accepted for one half of the amount specified in the instrument. When Morton refused six months later to pay as agreed, Clarke notified the drawer and brought an action to recover on the draft. Was he entitled to judgment?

8. Nagle presented a draft for acceptance to Rollo Merrill, the drawee. Merrill would give only an acceptance to pay one month later than the time specified in the instrument. Thereupon Nagle notified the drawer and brought an action to recover the amount of the draft from the drawer. Was he entitled to judgment?

9. Sheldrake issues a bill payable to Hairston sixty days after sight. Nine months later, Hairston presents the instrument for acceptance, and it is dishonored. Hairston brings an action on the instrument against Sheldrake. Is he entitled to judgment?

10. The holder of a draft payable on August 10 presents the instrument for acceptance on July 10, and the drawee refuses to accept. The holder brings action on the instrument against the drawer. The latter contends that the holder is not entitled to present this type of draft for acceptance. Is his contention sound?

11. Wade, Bliler, and Glick are named as drawees in a draft payable thirty days after sight. Wade dies shortly after the draft is issued. To whom must the holder present the instrument for acceptance?

12. Donnelly executed and delivered a draft that required presentment for acceptance. The holder made a fruitless effort to present the instrument for acceptance to the drawee on Saturday afternoon at three o'clock. In an action brought by the holder against Donnelly, it was contended that presentment for acceptance may be made on any day except Sunday. Do you agree?

13. The holder of an overdue bill of exchange brings an action against the acceptor. The latter claims he is not liable on the ground that the bill was not presented for payment on the due day. Is his contention sound?

14. Bentley, the payee of a draft, indorsed the instrument to Yarcho, who presented the draft for payment after it was due. When payment was refused, Yarcho gave due notice of the dishonor to Bentley. Thereafter Yarcho brought an action against Bentley to recover on the draft. Was he entitled to judgment?

15. Pitts executes a draft directing Land, a nonexisting person to pay Wainer $500 on May 1, 19—. When the instrument is not paid at maturity, Wainer brings an action against the drawer. Pitts contends that he is not liable because Wainer did not present the instrument for payment. Is this a valid defense?

16. Edson indorsed to O. A. Mallory a draft that had been accepted by Gleason, the drawee. Mallory, upon discovering that Gleason had died, presented the instrument at maturity to the executor of Gleason's estate for payment. In an action brought by Mallory against Edson, it was contended that there had not been a sufficient presentment. Do you agree?

17. A note executed by M. R. Wilson, Ellis Chaney, and Andrew Bailes was negotiated by Rodgers, the payee, to the Humboldt Machinery Company. At the maturity of the instrument the company presented the note to Chaney, who refused payment. In an action brought by the company against Rodgers, it was contended that there had not been sufficient presentment. Was this contention sound?

18. Bogert executes a promissory note payable to Owen and places his home address below his signature. Owen indorses the note to Balch. When the instrument matures, Balch presents it for payment at Bogert's place of business but finds no one there. In an action brought by Balch against Owen, the latter contends that he is not liable because the instrument was not properly presented for payment. Is his contention sound?

19. Tefft executes a promissory note and a draft both payable on demand. The note is negotiated to Sheldon, and the draft is negotiated to Minton. Are Sheldon and Minton allowed the same period of time for presentment of the instrument for payment?

20. Quimby drew a check payable to the W. H. Merrill Company. After the lapse of a reasonable time following the date of issue, the drawee bank failed. In an action brought by the company against the drawer, Quimby contended that he had been discharged from liability on the check. Was his stand well taken?

Part VI—Notice of Dishonor and Protest

Dishonor. A draft is dishonored by nonacceptance when it is properly presented for acceptance and the drawee refuses to accept it. An apparent refusal to accept by destroying or by refusing to return the instrument within twenty-four hours, however, is deemed to be an acceptance rather than a dishonor under the provisions of the Negotiable Instruments Law.[1] The act also provides that a bill is dishonored by nonacceptance "when presentment for acceptance is excused, and the bill is not accepted." [2] Presentment for acceptance is excused: (1) if the drawee is dead, has absconded, or is a fictitious person or a person without capacity to make a binding acceptance; (2) if, after the exercise of reasonable diligence, the holder cannot make presentment; or (3) when, although presentment has not been proper, acceptance has been refused on some other grounds.[3]

> Section 137 of the Negotiable Instruments Law, which declares that the destruction of or the refusal to return a bill by the drawee constitutes an acceptance, is omitted in the Illinois statute. It has been amended in Alabama, New Mexico, Pennsylvania, Wisconsin, and Wyoming. (5 Uniform Laws Annotated, Cumulative Annual Pocket Part for use during 1946)

If a draft is not accepted within the time allowed, the holder must treat it as dishonored in order to have recourse against the drawer and the indorsers. In such a case he has an immediate right against these parties upon sending out due notice of dishonor, and need not present the instrument for payment.

> "Where a bill is duly presented for acceptance and is not accepted within the prescribed time, the person presenting it must treat the bill as dishonored by nonacceptance or he loses the right of recourse against the drawer and indorsers." (Negotiable Instruments Law, Sec. 150)

Both drafts and notes are dishonored when they are properly presented for payment, and the drawee, acceptor, or maker, as the case may be, refuses to pay the instrument, or

[1] §137.
[2] §149.
[3] N. I. L., §148.

payment cannot be obtained. The Negotiable Instruments Law also provides that an instrument is dishonored by nonpayment when "presentment is excused and the instrument is overdue and unpaid." [4] Presentment for payment is excused: (1) if, after the exercise of reasonable diligence, presentment as required cannot be made; (2) if the drawee is a fictitious person; or (3) if there is a waiver of presentment.[5]

Notice of Dishonor. In the event of the dishonor of a negotiable instrument, due notice of the dishonor must, with exceptions to be noted, be given to the drawer and all indorsers. The holder releases from liability any drawer or indorser to whom he does not give such notice. It is sufficient, however, if he notifies the agent of the party. Notice must be given to all joint parties, except when one is authorized to receive notice for all of them, or when the parties are partners. Notice to one partner is sufficient to bind all members of the firm "even though there has been a dissolution." [6]

> "Where a party has been adjudged a bankrupt or an insolvent, or has made an assignment for the benefit of creditors, notice may be given either to the party himself or to his trustee or assignee." (Negotiable Instruments Law, Sec. 101)

In most states no particular form of notice is required. Except in Kentucky, it may be oral or written. The only requirement is that the terms of the notice "sufficiently identify the instrument, and indicate that it has been dishonored by nonacceptance or nonpayment." [7] Even a misdescription of the instrument does not render the notice invalid, unless it misleads the party to whom the notice is given.

Sufficiency of Notice. Due notice requires that the notice be given within a reasonable time. What constitutes a reasonable time will, of course, vary with the circumstances. When the holder and the person to be notified reside in the same

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[4] §83.
[5] N. I. L., §82.
[6] N. I. L., §99.
[7] N. I. L., §96.

place, notice, if given at the place of business, must be given during business hours not later than the day following dishonor. If the notice is given at the latter's residence, it should be given not later than the usual hours of rest on the following day. If it is sent by mail, it must be posted so as to reach him on the day following.[8]

When the parties reside in different places, notice, if sent by mail, must be deposited so as to go not later than the day following. When no mail goes at a convenient hour on that day, however, notice must go by the next mail thereafter. If notice is given other than by mail, it must be given within the time taken by a proper notice by mail.[9] Each party receiving notice of dishonor is allowed the same time in which to notify preceding parties.

A note was dishonored on February 5, and the holder, residing in Denver, gave oral notice to an indorser, residing in Colorado Springs, about nine a. m. on February 7. The oral notice, being within the time allowed for notice by mail, was sufficient. (De La Vergne v. Globe Printing Co., 27 Colo. A. 308, 148 P. 923)

The place to which notice is to be sent also depends upon the attending circumstances. If an address appears with the signature of the party, notice of dishonor should be mailed to such address. If the address is not given, the holder must send notice to the place where the party usually receives his mail or to the post office nearest his place of residence. If, however, the party has his business and his residence in different places, then notice may be sent to either place. The party may be sojourning at a certain place, in which case notice may be sent there.

A bank, as holder, sent to an indorser, C. C. Merrill, notice of dishonor in a letter addressed to him at 2277 West Twenty-third Street, Los Angeles, California, which was not received. A current directory showed Merrill's business address to be 727 West Seventh Street, Los Angeles, and his home address in Beverly Hills. The notice was not properly given. (Bank of America Nat. T. & Sav. Ass'n v. Century L. & W. Co., 19 Calif. A. [2d] 197, 65 P. [2d] 110)

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[8] N. I. L., §103.
[9] N. I. L., §104.

The Negotiable Instruments Law has adopted these rules but expressly provides that "where the notice is actually received by the party within the time specified in this act, it will be sufficient, though not sent in accordance with the requirements." [10] When notice is lost, it is deemed to have been given, provided it was properly addressed and deposited in the post office. The latter requirement is met by placing the notice within the control of the post-office department, as by depositing it in a letter box or in a branch post office.

> A letter containing notice, properly addressed, was left in a place in a notary's office where mail was usually collected by the postman. This was not a proper mailing of the notice; but the indorser, having received the notice within the time allowed, was not discharged. (Friedman v. Maltinsky, 260 Pa. 312, 103 A. 731)

Notice of dishonor need not be given to a drawer or indorser when it has been expressly or impliedly waived. Waiver of notice may be made before the time to give notice or after a failure to give due notice. Failure to give notice is also excused when notice is impossible or the party does not receive it, provided the holder has exercised reasonable diligence.

> The holder of a note, brother of the maker, attempting to locate the residence of an indorser, merely inquired at a place where the indorser formerly worked. The court declared: "I do not think that this inquiry alone showed reasonable diligence. It was not even shown that he inquired of the maker for defendant's address. It was his duty 'at least immediately to apply to the other parties to the note for this information.'" (Silver v. Loucheim, 84 Misc. Rep. 234, 147 N. Y. S. 29)

The Negotiable Instruments Law also provides that it is unnecessary to give notice of dishonor, in order to charge an indorser, "(1) where the drawee is a fictitious person or a person not having capacity to contract, and the indorser was aware of the fact at the time he indorsed the instrument; (2) where the indorser is the person to whom the instrument

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[10] §108.

is presented for payment; (3) where the instrument was made or accepted for his [the indorser's] accommodation." [11] Another provision dispenses with notice of dishonor to the drawer "(1) where the drawer and drawee are the same person; (2) where the drawee is a fictitious person or a person not having capacity to contract; (3) where the drawer is the person to whom the instrument is presented for payment; (4) where the drawer has no right to expect or require that the drawee or acceptor honor the instrument; (5) where the drawer has countermanded payment." [12]

Protest. The term *protest* technically applies to a formal writing by a proper person, stating that the instrument was properly presented and that payment was refused. Any negotiable instrument may be protested for nonacceptance or nonpayment. Foreign bills of exchange, including checks, must be protested for nonacceptance and, if not dishonored by nonacceptance, must be protested for nonpayment. This rule does not apply, however, when the fact that the bill is a foreign bill does not appear on its face.[13] The reason for requiring a

The State of SOUTH CAROLINA RICHLAND County, ss.

Columbia, June 1, 19

Take Notice, *that a* check *for* $25.88

dated May 28, 19

drawn by M. R. French

in favor of L. C. Baldwin

on the South Carolina National Bank

~~accepted by~~

indorsed by L. C. Baldwin and the Peoples First National Bank

was this day presented for payment *which was refused, and therefore was this day Protested, by the undersigned Notary Public, for non* payment

The holder therefore looks to you for payment thereof, together with interest, damages, costs, etc., you being payee *thereof.*

H. J. Stevenson

To L. C. Baldwin, Charleston, S. Car. *Notary Public*

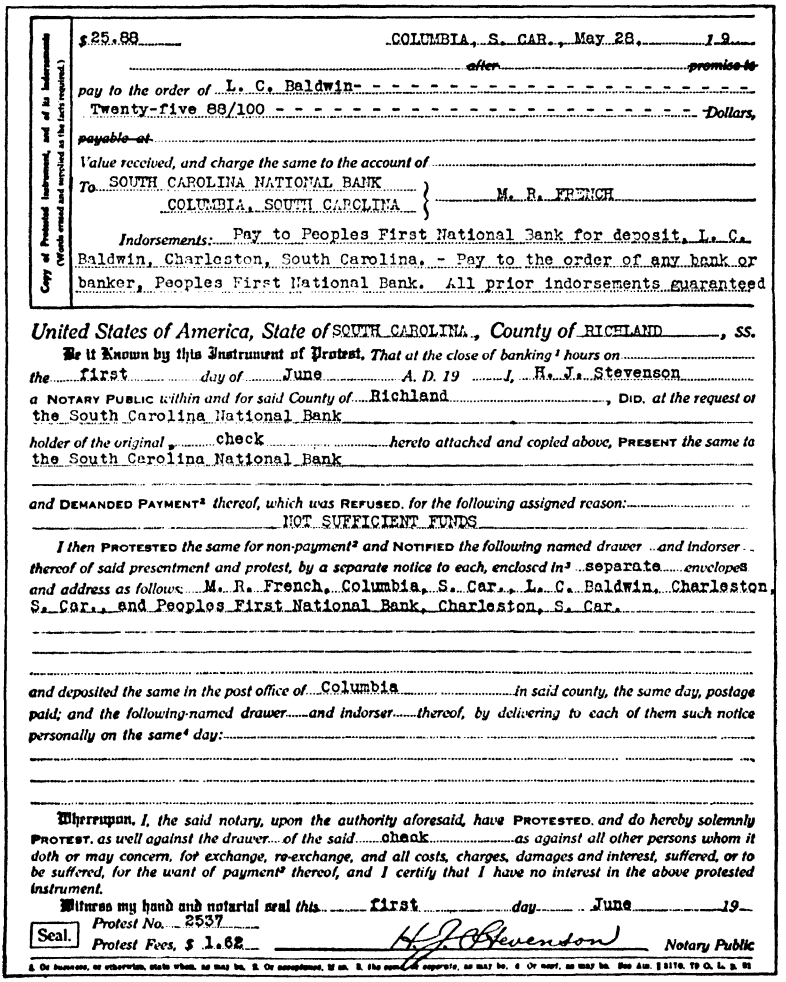
NOTICE OF PROTEST

[11] §115.
[12] §114.
[13] N. I. L., §152.

protest in case of foreign bills of exchange is to furnish proof of proper presentment and dishonor, of which satisfactory evidence would be difficult for a holder or indorser to obtain because of foreign residence. If such bills are not protested, the drawer and indorsers are discharged, except when the circumstances would excuse notice of dishonor.

In many states statutes make the certificate of protest made by a notary "prima facie evidence of the facts therein

Copy of Protested Instrument, and of its Indorsements (Words erased and supplied as the facts required.)



$25.88 COLUMBIA, S. CAR., May 28, 19

~~after~~ ~~promise to~~

pay to the order of L. C. Baldwin- -

Twenty-five 88/100 - Dollars,

~~payable at~~

Value received, and charge the same to the account of

To SOUTH CAROLINA NATIONAL BANK
COLUMBIA, SOUTH CAROLINA } M. R. FRENCH

Indorsements: Pay to Peoples First National Bank for deposit, L. C. Baldwin, Charleston, South Carolina. - Pay to the order of any bank or banker, Peoples First National Bank. All prior indorsements guaranteed

United States of America, State of SOUTH CAROLINA, *County of* RICHLAND, *ss.*

Be it Known by this Instrument of Protest, *That at the close of banking*[1] *hours on* the first *day of* June *A. D. 19* *I,* H. J. Stevenson *a* NOTARY PUBLIC *within and for said County of* Richland, DID, *at the request of* the South Carolina National Bank *holder of the original* check *hereto attached and copied above,* PRESENT *the same to* the South Carolina National Bank *and* DEMANDED PAYMENT[2] *thereof, which was* REFUSED, *for the following assigned reason:* NOT SUFFICIENT FUNDS

I then PROTESTED *the same for non-payment*[2] *and* NOTIFIED *the following named drawer and indorser thereof of said presentment and protest, by a separate notice to each, enclosed in*[3] separate *envelopes and address as follows:* M. R. French, Columbia, S. Car., L. C. Baldwin, Charleston, S. Car., and Peoples First National Bank, Charleston, S. Car.

and deposited the same in the post office of Columbia *in said county, the same day, postage paid; and the following-named drawer and indorser thereof, by delivering to each of them such notice personally on the same*[4] *day:*

Whereupon, *I, the said notary, upon the authority aforesaid, have* PROTESTED, *and do hereby solemnly* PROTEST, *as well against the drawer of the said* check *as against all other persons whom it doth or may concern, for exchange, re-exchange, and all costs, charges, damages and interest, suffered, or to be suffered, for the want of payment*[2] *thereof, and I certify that I have no interest in the above protested instrument.*

Witness my hand and notarial seal this first *day* June *19*

Seal. *Protest No.* 2537
Protest Fees, $ 1.62 H. J. Stevenson *Notary Public*

1. Or business, or otherwise, state when, as may be. 2. Or acceptance, if so. 3. The same, or separate, as may be. 4. Or next, as may be. See Am. § 3170, 79 O. L. p. 91

CERTIFICATE OF PROTEST

stated as to demand and refusal of payment and notice of dishonor to the parties to the note." (Eames v. Keeton, 196 Mo. A. 424, 193 S. W. 629)

Checks drawn in one state and payable in another state are deemed foreign bills because our states are largely sovereign territories, having separate jurisdictions in respect to judicial, administrative, and executive powers. The need for obtaining satisfactory evidence of proper presentment and dishonor in the case of a check that is payable in another state is the same as though the check were payable in another country. Because of the expense of protests, however, businessmen commonly waive protest on out-of-state checks.

"A waiver of protest, whether in the case of a foreign bill of exchange or other negotiable instrument, is deemed to be a waiver not only of a formal protest but also of presentment and notice of dishonor." (Negotiable Instruments Law, Sec. 111)

Although a protest is ordinarily made by a notary public, the Negotiable Instruments Law expressly provides that it may be made also "by any respectable resident of the place where the bill is dishonored, in the presence of two or more creditable witnesses." [14] A bill must be protested on the day of dishonor. Delays which are due to no fault of the holder but to causes beyond his control will, however, be excused. The proper place for protesting a bill is ordinarily the place where it is dishonored. The protest must be annexed to the instrument, or it must contain a copy of the bill.

"Where a bill is lost or destroyed or is wrongfully detained from the person entitled to hold it, protest may be made on a copy or written particulars thereof." (Negotiable Instruments Law, Sec. 160)

The certificate of protest must contain all pertinent facts surrounding the transaction. It should specify the time and place of presenting the instrument, contain a recital of the fact that the bill was presented, and state the manner of presentment. The reason or cause for protesting the instrument must also be given. Finally the certificate must specify

[14] §154.

"the demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found." [15]

Acceptance and Payment for Honor. When an instrument has been dishonored by either nonacceptance or nonpayment, it is not always necessary for the holder to resort to prior parties for reimbursement. There may be some person who will assume the burden of accepting or paying the instrument. Such a person may be one who owes money to the drawer and wishes to discharge his obligation to the extent of the amount of the draft. He may be a friend who wishes to avoid an injury to the credit of the drawer that might result from the dishonored instrument going back through the various indorsers. More frequently today, however, such a person is one who is designated in the instrument by the drawer. For example, a merchant in New York may pay his own obligations by giving three drafts drawn on his debtors in London, Paris, and San Francisco. Because he does not wish to be burdened with protest fees or to suffer loss of credit by a dishonor of any of these drafts, the merchant may indicate in each instrument a person in the city of the drawee to whom the holder may present the draft for acceptance or payment in case the drawee dishonors the instrument. Such a person, as previously noted, is known as a referee in case of need.[16]

> "It is in the option of the holder to resort to the referee in need or not, as he may see fit." (Negotiable Instruments Law, Sec. 131)

Acceptance for Honor. With the consent of the holder, any person not a prior party to a bill of exchange protested for dishonor by nonacceptance may intervene and, if the instrument is not overdue, accept the bill *supra* protest for the honor of any party liable thereon. If such acceptance does not indicate for whose honor it is made, it is treated as though made for the honor of the drawer.[17] When the bill is payable at a specified time after sight, the time runs from the date of the nonacceptance, and not from the date

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[15] N. I. L., §153.
[16] *Ante*, p. 299.
[17] N. I. L., §163.

of the acceptance for honor. The acceptance for honor must be in writing and signed by the acceptor for honor. It must also indicate that it is an acceptance for honor.[18]

> "The acceptor for honor is liable to the holder and to all parties to the bill subsequent to the party for whose honor he has accepted." (Negotiable Instruments Law, Sec. 164)

This acceptance does not make the acceptor for honor primarily liable. The instrument must be presented to the drawee for payment when it is due. If not paid, it must be protested for nonpayment, and due notice thereof given to the acceptor for honor. When presentment for payment to the acceptor for honor is to be made at a place other than that at which the instrument was protested, it must be mailed so as to go at a reasonable hour during the day following the protest, or, if there is no mail at a reasonable hour, by the next mail. Personal presentment must be made by the time the instrument would take to go by mail if it were posted as prescribed above. When the instrument "is to be presented in the place where the protest for nonpayment was made, it must be presented not later than the day following its maturity." [19] If not paid when presented to the acceptor for honor, the bill must again be protested for nonpayment.

> Delay in making presentment to the acceptor for honor "is excused when the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct, or negligence." (Negotiable Instruments Law, Sec. 169)

Payment for Honor. Any person may intervene in case a bill is dishonored by nonpayment and pay it *supra* protest for the honor of any person liable or on whose account it was drawn. It should be noted that the consent of the holder is not necessary. On the contrary, if the holder refuses to receive such payment, his right to recourse is lost as against any party who would have been discharged by the payment.[20] If two or more wish to pay for the honor of different parties,

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[18] N. I. L., §162.
[19] N. I. L., §168.
[20] N. I. L., §176.

preference must be given to the one whose payment will discharge most parties.

> A drawer paid to the payee the amount of a check that had been dishonored. Though it appears that the drawer, in so doing, was merely discharging his obligation to the payee, the court said: "The check having been dishonored and protested, the drawer, the plaintiff in this case, had the right to intervene and pay it to protect his honor." (Hooper v. Herring, 14 Ala. A. 455, 70 S. 308)

A payment for honor *supra* protest operates only as a voluntary payment, unless it is attested as such by a notary. The party paying must declare that he is paying for honor and state for whom he makes payment. The effect of payment is to discharge all parties subsequent to the party for whose honor he paid the bill. After paying the amount of the instrument and the expenses of the dishonor proceedings, the payer is entitled to the bill and the protest. He then has right of recourse against all parties liable thereon to the party for whose honor he made the payment.[21]

QUESTIONS

1. Spencer was the holder of a draft that he presented for acceptance to R. D. Segall, the drawee. Segall was angered by the fact that his creditor had issued the order to pay, and he threw the draft into a chute leading to a furnace where the instrument was consumed by fire. Spencer brought an action against the drawer, contending that the draft had been dishonored by nonacceptance. Was Spencer's stand well taken?

2. A draft was presented for acceptance to Talley, the drawee. Talley refused to return the draft accepted or nonaccepted. The holder, Haynes, immediately notified the drawer of Talley's action. Thereafter Haynes brought an action to recover on the draft from the drawer. Was Haynes entitled to judgment?

3. McKibben, the holder of a bill of exchange drawn by Bebb in Detroit, presents it for acceptance to the drawee who also lives there. The instrument is dishonored by nonacceptance. Three days later McKibben demands payment from Bebb. The latter refuses to pay, and McKibben brings an action on the instrument. Is he entitled to judgment?

4. Hertel is the holder of a dishonored draft indorsed by Jackson, Bargreen, and Dixon as members of a partnership. Notice of dishonor is given to Jackson only. Hertel brings an action against the members

[21] N. I. L., §175.

of the firm to recover on the draft. Bargreen and Dixon contend that they have been discharged from liability. Is this contention sound?

5. Axtel, the drawer of a bill, lives in the same city as the holder. The latter, upon dishonor of the instrument, sends notice of dishonor to Axtel at the latter's place of business on the following day after business hours. Has due notice been given Axtel?

6. Sherwood, who lives in Chicago, presents a bill of exchange to the drawee, who also lives in Chicago. The instrument is dishonored. Sherwood now wishes to send due notice of dishonor to the drawer, who lives in Los Angeles. How must notice of dishonor be given so as to be given within a reasonable time?

7. Ringling is an indorser of a bill and has received from the holder notice of its dishonor. He wishes to give notice to several prior indorsers who reside in the same city. What is required in giving due notice to these parties?

8. A holder properly mails a notice of dishonor to the drawer of a dishonored bill of exchange. It is lost en route. In an action brought by the holder against the drawer, the defense is that due notice was not given. Is the holder entitled to judgment?

9. Ensign was the holder of a draft that was dishonored by nonpayment. The draft was a foreign instrument, but this fact did not show on its face. In an action brought by Ensign against an indorser, the defendant contended that he had been discharged from liability by a failure to protest the instrument. Was this contention sound?

10. The National Stave Company was the holder of a draft. Upon dishonor by nonacceptance, the company refused to allow Torrence to accept supra protest for the honor of the drawer. After due notice of the dishonor, the company brought an action to recover on the draft from the drawer. Was it entitled to judgment?

11. Searle Rawlings was the holder of a draft that had been dishonored by nonacceptance. He permitted an acceptance for honor by Lipten. Promptly at maturity Rawlings presented the instrument to Lipten for payment, which was refused. Rawlings brought an action to recover the amount of the draft from Lipten. Was he entitled to judgment?

12. Leathers executed a draft payable to Munch thirty days after sight. Munch presented it to the drawee. It was dishonored by nonacceptance on July 6. On July 8 Mehaffie accepted the instrument for the honor of Leathers. The holder presented the draft for payment to the drawee thirty days after July 8, and payment was refused. After protest and notice thereof, the holder brought an action to recover from Mehaffie. Was the holder entitled to judgment?

13. The payee of a draft negotiated the instrument to Talbott, who in turn negotiated the draft to Cleve. The draft was dishonored when presented by Cleve for payment. The offer of Felin & Co. to pay supra protest for the honor of the payee was refused by Cleve. Thereafter, Cleve brought an action to recover on the instrument from Talbott. Was Cleve entitled to judgment?

Part VII—Rights of Holders

Holder in Due Course. Because a holder in due course enjoys rights denied other holders, it is necessary, although sometimes difficult, to determine who are holders in due course. In order to answer this question, the law merchant developed certain rules by which the status of the transferee was measured. These rules have been substantially codified by the Negotiable Instruments Law.[1]

Instrument Fair on Its Face. The first requirement is that the holder must have taken an instrument complete and regular on its face. In other words, when one takes an instrument with any irregularity appearing on the face thereof, he cannot claim the rights of a holder in due course. A transferee must observe whether the instrument is fair on its face. "A note may carry on its face such a danger signal that the purchaser may disregard it only at his peril. It may in many forms, in the language of Lord Denman, 'bear its death wound on its face.' " [2]

> L. F. Messman took a note which showed an obvious erasure and change in the name of the payee. It was held that the instrument was not regular on its face. (Messman v. Wilt, 91 Okla. 240, 217 P. 412)

Before Overdue. Although an instrument is negotiable when overdue, one taking it after maturity is not a holder in due course. The fact that an instrument is being circulated when it is overdue is a suspicious circumstance. "The question instantly arises: Why is it in circulation? Why is it not paid? Here is something wrong. Therefore, although it does not give the indorsee notice of any specific matter of defense, such as set-off, payment, or fraudulent acquisition, it puts him on inquiry; he takes only such title as the indorser himself has, and subject to any defense which would be made, if the suit were brought by the indorser." [3] The Negotiable Instruments Law also expressly states that one is not a holder in due course to whom "an instrument which is payable on

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[1] §52.
[2] *Gaston* v. *Campbell Co.*, 104 Tex. 576, 141 S. W. 515.
[3] *Fisher* v. *Leland*, 4 Cush. (Mass.), 456.

demand is negotiated an unreasonable length of time after its issue." [4]

> In holding that twenty months was an unreasonable time, the court applied Section 193 of the Negotiable Instruments Law, which provides: "In determining what is a 'reasonable time' or an 'unreasonable time' regard is to be had to the nature of the instrument, the usage of trade or business (if any) with respect to such instruments, and the facts of the particular case." (Title Loan & Investment Co. v. Fuller, 105 Kans. 395, 184 P. 727)

Without Notice of Dishonor. One is not a holder in due course when he takes an instrument before maturity, but with notice that it has been dishonored. Knowledge of dishonor for nonacceptance, for instance, should cause the transferee to consider the possible reasons therefor and put him on inquiry, as in the case of an overdue instrument.

> Most modern decisions hold that the fact "that interest on a note was not paid does not constitute notice of dishonor to an indorsee." (Kreitz v. Savings Deposit Bank & Trust Co., 21 Ohio A. 354, 153 N. E. 236)

For Value. To be a holder in due course, one must give value for the instrument. Thus one who takes a bill or note as a gift is not a holder in due course.[5] What constitutes value in this connection is a question that has not been answered uniformly by our courts. The better rule, it seems, is that the giving of a consideration sufficient to support the contract is enough to make the one so doing a holder for value.

> Some modern decisions, contrary to the majority rule, have adopted the better view under the Negotiable Instruments Law that "the mere crediting an account by a bank is value." (Farmers' & Merchants' Bank v. Nissen, 46 S. D. 121, 190 N. W. 1014)

Good Faith. The giving of value must also be in good faith. Although full value need not be given in order to be a holder in due course, a gross inadequacy of consideration may be evi-

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[4] §53.
[5] *Greer* v. *Orchard*, 175 Mo. A. 494, 161 S. W. 875.

dence of bad faith. Even when full value is given, the circumstances may be such as to show lack of good faith. In all cases the requirement of good faith applies only to the transferee. Thus one may be a holder in due course, even though his transferor has acted in bad faith.[6]

> "We conclude that the statute means and says that under section 52, a holder must take in good faith, but if he does not take in bad faith, his good faith is sufficiently shown, and bad faith under section 52 means that he must have knowledge of facts which render it dishonest to take the particular piece of negotiable paper under discussion." (Gerseta Corporation v. Wessex-Campbell Silk Co., 3 F. [2d] 236)

Notice of Any Defenses. One who takes an instrument with notice of equities of defense or of title is not a holder in due course. Notice in this case means knowledge on the part of the transferee of certain facts. "Those facts may be actual knowledge of a defect in the title, or want of consideration, or such facts as would constitute a defense to the note as between the maker and original payee; or actual knowledge of such facts and circumstances as would lead an honest and fair businessman to make further inquiry and which inquiry if made would lead to the discovery of the fraud." [7] The Negotiable Instruments Law expressly defines *notice* in respect to defects in substantially these terms.[8] One paying part before notice is a holder in due course to the extent of such payment, but not as to the money paid later.

Personal and Real Defenses. Because a holder in due course takes a negotiable instrument free from personal defenses and subject only to real defenses, it is important to keep in mind the distinction between them. In the absence of statute, the nature of the claim rests on the rules of common law.

Personal defenses are legal and equitable claims which one may be justified in setting up against a particular person and his transferee, provided the latter is not a holder in due course.

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[6] *Eden* v. *Gibson,* 100 S. C. 353, 84 S. E. 1005.
[7] *Vaughn* v. *Johnson,* 20 Ida. 669, 119 P. 879.
[8] §56.

Personal defenses grow out of the acts of the immediate parties. They ordinarily include claims based on payment, set-off and counterclaim, undue influence, lack of consideration, fraud, collateral conditions, and duress.[9]

> "In the hands of any holder other than a holder in due course, a negotiable instrument is subject to the same defenses as if it were nonnegotiable." (Negotiable Instruments Law, Sec. 58)

Real defenses are those which attach to the instrument and are valid against everyone. Defenses of this nature exist in situations in which there is no liability at all, in which the party may avoid the instrument against everyone, or in which the agreement as a matter of public policy cannot be enforced. In these instances the rights of a holder in due course are no greater than those of the party he seeks to hold, or are subordinated for the public good. Examples of real defenses are forgery, incapacity of parties to contract, Statute of Limitations, and illegality which renders an agreement void.[10]

Incomplete Instruments. In some instances one may be given an instrument which is incomplete by reason of blanks being left open. The question then arises as to the rights of the holder. "The general proposition, to which there does not seem to be any dissent, is that a person who receives a note for use, with blanks unfilled, the filling of which is necessary to complete the instrument and render it operative, is thereby given implied authority to make such insertions as are necessary to form a complete and enforceable contract." [11] This rule applies to blanks which should show such information as the name of the payee, interest, place of payment, or amount. The Negotiable Instruments Law adopts the rule of implied authority to fill blanks within a reasonable time, and also expressly provides that "where an instrument expressed to be payable at a fixed period after date is issued undated, or where the acceptance of an instrument payable at a fixed period after sight is undated, any holder may insert therein

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[9] *Rossiter* v. *Loeber*, 18 Mont. 372, 45 P. 560.
[10] *Ensign* v. *Coffelt*, 102 Ark. 568, 145 S. W. 231.
[11] *Young* v. *Baker*, 29 Ind. A. 130, 64 N. E. 54.

the true date of issue or acceptance, and the instrument shall be payable accordingly." [12]

> The payee of a note issued with blanks did not complete the instrument until ten months thereafter. It was held that the lapse of time from September to the following July "is not ipso facto an unreasonable time before the blanks were filled in." (Allen v. Rouseville Cooperage Co., 157 Va. 355, 161 S. E. 50)

If the incomplete instrument is filled out in excess of authority, the wrongdoer cannot enforce it. Unauthorized completion of a blank is also generally a good defense against one who takes the instrument with knowledge of the abuse of authority. If the instrument, after wrongful completion, comes into the hands of a holder in due course, excess of authority is no defense either at common law or under the provisions of the Negotiable Instruments Law. "No rule is better settled, or founded upon stronger reasons, than that which affirms the liability of one intrusting his name in blank to another, to the full extent to which such other may see fit to bind him, when the paper is taken in good faith and without notice, actual or implied, that the authority given had been exceeded or the confidence reposed had been abused." [13]

Right to Sue. A holder of a negotiable instrument is entitled to bring an action thereon in his own name. This is true under the Negotiable Instruments Law, even though he has no beneficial interest, as Section 37 of the act allows a holder for collection only to sue in his own name. The holder may strike out any indorsement not necessary to his title. By doing so, however, he discharges all indorsers subsequent to the one struck out.[14] Ordinarily the holder may proceed against any prior indorser. An exception to this rule exists, however, when he has previously held and indorsed the instrument. In this event he cannot sue any intervening party to whom his first indorsement makes him liable.[15] This prevents circuity of action, for the intervening party could in turn sue him.

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[12] §13.
[13] *Fullerton* v. *Sturges*, 4 Ohio St. 530.
[14] N. I. L., §48.
[15] N. I. L., §50.

Holding that a second indorser was prima facie not liable to the first indorser, the court applied Section 68 of the Uniform Negotiable Instruments Law, which provides: "As respects one another, indorsers are liable *prima facie* in the order in which they indorse; but evidence is admissible to show that as between or among themselves they have agreed otherwise." (Perley v. Wing, 82 N. H. 299, 133 A. 26)

Equities classed as personal defenses cannot be set up against a holder in due course.[16] The latter takes the instrument free from such claims of prior parties, although they may be valid as against his transferor. The holder in due course, however, does not take the instrument free from claims classed as real defenses. Any holder who is not a holder in due course takes the instrument subject to both real and personal defenses. In respect to such a party, the instrument is considered as though it were nonnegotiable. An exception to this rule exists where such holder takes from a holder in due course, provided he has not been a party to any fraud or illegality affecting the instrument.[17] This rule is not to favor such a holder, but it is necessary in order to give his transferor full rights of disposal. If his transferee could not enforce the instrument, the holder in due course would be restricted seriously in some cases in transferring it.

Certified Checks. It has been noted above that the holder has no rights against a drawee bank for refusing to pay an ordinary check drawn by a depositor. This rule, however, does not apply to a check that has been certified. *Certification* of a check is an agreement on the part of the bank that it will pay the check when presented for payment in the future. If the instrument is certified by the bank on which it is drawn, the certification is equivalent to an acceptance.[18]

"A check of itself does not operate as an assignment of any part of the funds to the credit of the drawer with the bank, and the bank is not liable to the holder, unless and until it accepts or certifies the check." (Negotiable Instruments Law, Sec. 189)

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[16] *Ante*, p. 343.
[17] N. I. L., §58.
[18] N. I. L., §187.

The certification of a check is not a formal transaction employing any particular requisites. Any form of words is sufficient so long as the character of the transaction is indicated. Ordinarily a check is certified by writing or printing the word *certified* on the face thereof, with the signature of the cashier or other proper officer, and the date.

A bank teller told the holder of a check that the check was good and that the maker had money enough on deposit to pay it. Payment was refused later because the drawer of the check had withdrawn the entire amount of his account. Holding that there had been no acceptance or certification under the Negotiable Instruments Law, the court declared: "The certification can of course only be given in writing." (Ewing v. Citizens Nat. Bank, 162 Ky. 551, 172 S. W. 955)

The holder of a check may procure the certification or acceptance, or the check may be certified or accepted at the request of the drawer. In the former instance all indorsers and the drawer are released from liability.[19] This rule is based on the ground that when the check was presented by the holder or his agent, the money could have been obtained; hence there is no reason for the drawer and indorsers to remain liable, since the holder has elected to take what amounts to a promissory note on the part of the bank. The theory is that the holder received payment and returned the money to the bank, taking the latter's promise that it would be paid. On the other hand, when the certification is not procured by the holder, there is no just reason for discharging the drawer and indorsers. In fact, it would be an injustice to allow a drawer to substitute for his obligation that of a bank, thus making the holder assume the risk of the failure of a bank not of his own choice.

QUESTIONS

1. A bill of exchange is negotiated to Tenzel, who knows that it has been dishonored. Kenyon maintains that Tenzel is not a holder in due course. Is his contention sound?

2. Picket is induced by fraud to execute a note for $800 payable to Lange. The instrument is purchased by Kelso for $700. When Kelso sues on the note, Picket contends that he is not entitled to recover

[19] N. I. L., §188.

because he did not give full value for the instrument. Is Picket's contention sound?

3. Langan, by fraud, obtains a note for $500 from Sennett and sells the instrument to Patriquin on terms of $300 cash and $100 a month. Later Patriquin learns of the fraud, but he nevertheless pays one installment of $100. What are his rights on the note against Sennett?

4. On January 18, Stillman issues a draft payable to Ferrill sixty days from date, but he fails to date the instrument. Ferrill inserts January 18 in the blank. The instrument is dishonored by nonpayment. Ferrill brings an action against Stillman, who contends that Ferrill was not entitled to insert the date. Was Ferrill entitled to insert the date?

5. Wayne issues a promissory note payable to Beren on demand, but he does not state the amount in the instrument. The latter fills in the blank, making the note payable for $1,000 instead of $500 as Wayne intends. Beren sues Wayne on the note. Is he entitled to judgment?

6. The payee of a draft indorsed the instrument in blank to Sterns, who in turn negotiated the draft by blank indorsement to Wagner. Thereafter Wagner negotiated the instrument by blank indorsement to Ralph Carroll. After scratching out the indorsement of Sterns, Carroll brought an action against Wagner on the note that had been dishonored. Was Carroll entitled to judgment?

7. A note is negotiated to Pegler, who indorses it in blank to Scarnoff. The latter negotiates the instrument to Hayes, who indorses it to Pegler. The maker of the note is unable to pay the note at maturity. Pegler brings an action on the instrument against Scarnoff. Is he entitled to judgment?

8. Wasson, the payee of a note, by an indorsement without recourse transferred the instrument to Delaney. Thereafter the note was negotiated by blank indorsement by Delaney to Davis and by Davis to Wasson. The maker of the note refused payment thereof at maturity on the ground of infancy. Wasson brought an action to recover the amount of the note from Davis. Was he entitled to judgment?

9. A certified check was indorsed to Bronson. The drawee bank refused to pay the instrument when it was presented for that purpose by Bronson. Thereafter Bronson brought an action on the check against the bank. Was he entitled to judgment?

10. The payee of a check has it certified by the drawee bank. Before the check is presented for payment, the bank fails. The payee sues the drawer of the check for the amount of the check. Is he entitled to judgment?

11. Kane borrowed the sum of $130 from Edward Rogers. In payment of the debt he sent Rogers a certified check. Rogers received the check in the morning and attempted to cash the instrument in the afternoon, but he found that the drawee bank had closed its doors at noon. In an action on the instrument brought by Rogers, Kane contended that he had no liability because the check had been certified. Was this contention sound?

Part VIII—Discharge

Payment. A negotiable instrument may be discharged by proper payment. The Negotiable Instruments Law provides for the discharge of negotiable instruments when they are paid in due course for or by the principal debtor, and when they are paid in due course by one who has been accommodated, in case the instrument has been made or accepted for accommodation.[1] Payment other than in due course will not discharge the instrument. Payment in due course is made when it "is made at or after the maturity of the instrument to the holder thereof in good faith and without notice that his title is defective." [2] A payment by one secondarily liable does not discharge the instrument. The payer holds it to enforce against prior indorsers and the principal debtor. He may also strike out his and subsequent indorsements and further negotiate the instrument. The Negotiable Instruments Law denies this right when the drawer pays an instrument which is payable to the order of a third person, or when an accommodated party pays an instrument executed or accepted for accommodation.[3] This denial is based on the theory that further negotiation would unfairly continue the liability of the payee indorser or of the person who executed or accepted the instrument for the accommodation of the person making payment.

> Byars, who was an indorser of a note executed by Roberts, had to pay the amount of the instrument to an indorsee. Byars was entitled to enforce the note against the maker. (Roberts v. Byars, 210 Ky. 788, 276 S. W. 839)

Ordinarily payment must be in money, but by agreement it may be made in other forms of personal property. The giving of a new note or bill may or may not be payment according to the intention of the parties. Unless clearly indicated, it is not generally considered payment. Generally speaking, the same rule applies if the bill or note of another is accepted by the holder.

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[1] §119.
[2] N. I. L., §88.
[3] §121.

"The authorities are agreed that whether a renewal note operates as a discharge of the note of which it is a renewal is dependent on the intention of the parties." (First Nat. Bank v. Yowell, 155 Tenn. 430, 294 S. W. 1101)

The person paying the instrument should demand the surrender of the instrument when paid. Payment is a personal defense and is not valid against a holder in due course. Thus, if a maker pays the original payee after the note has been transferred to a holder in due course, the maker is liable for payment to such a holder.[4] The possession by the payer of a receipt for payment is no substitute for the surrender of the instrument.

Debtor as Holder. A negotiable instrument is discharged when the primary debtor becomes the holder of it at or after maturity. This rule is adopted by the Negotiable Instruments Law.[5] The mere possession of the instrument by the principal debtor, however, does not discharge it. Securing the instrument unfairly or on the behalf of another is insufficient. To illustrate, if the principal debtor acquires the instrument without the consent of the holder, as by fraud, or without meeting the required conditions, or if he acquires it rightfully, but as an agent for another party, the instrument is not discharged.[6] The second essential to this method of discharge is that the principal debtor must have become a holder at or after maturity of the instrument. If the instrument was acquired before maturity, he may further negotiate it as in the case of any other note, or as in the case of any other holder.

Facts Discharging Simple Contracts. A negotiable instrument in some instances may be discharged in the same way as a simple contract for the payment of money. It may be discharged by operation of law in the case of bankruptcy, in the case of lapse of time under the Statute of Limitations, or in the case of a judgment being rendered thereon, at least as to the parties against whom the judgment is obtained. The instrument may also be discharged by agreement. Thus it may

[4] *Shoemaker* v. *Minkler*, 202 Iowa 942, 211 N. W. 563.
[5] §119—(5).
[6] *People's State Bank* v. *Dryden*, 91 Kans. 216, 137 P. 928.

be discharged by an accord and satisfaction, novation, covenant not to sue, rescission, or substitution of another obligation.[7]

> The holder of a note agreed to accept a conveyance of a house and lot and certain acts by the maker in payment of the note. The acceptance of these performances discharged the instrument. (Bank of Amsterdam v. Welliver, 215 Mo. A. 247, 256 S. W. 130)

The Negotiable Instruments Law states that a negotiable instrument will be discharged by any "act which will discharge a simple contract for the payment of money." [8] If this section is construed literally, it will upset the long-settled and fair rule that payment before maturity is no defense against a holder in due course. Courts may hold, however, that this provision, in view of other sections, refers only to a holder demanding payment who has been paid. Thus it has been held that this section does not apply to holders in due course, on the theory that it conflicts with other provisions of the Negotiable Instruments Law; hence it is intended to apply only to the immediate parties.[9]

Renunciation. A negotiable instrument may be discharged by renunciation. A holder may at any time renounce his rights against any party to the instrument, thus releasing the latter from any liability to him. If he expressly renounces unconditionally and absolutely his rights against the principal debtor, before, at, or after maturity of the instrument, the latter is discharged as to such holder or parties with notice. The Negotiable Instruments Law requires that a renunciation "be in writing, unless the instrument is delivered up to the person primarily liable thereon." [10]

> The payee of a note signed the following indorsement: "If the payee of this note does not survive the maker thereof, then this note is not to be paid, but is to be cancelled and surrendered." This did not constitute a renunciation which must be absolute and unconditional. (Daugherty v. Preuitt, 113 Okla. 66, 242 P. 529)

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[7] *McDonnell* v. *Ala. Gold Life Ins. Co.*, 85 Ala. 401, 5 S. 120.
[8] §119—(4).
[9] *Manchester* v. *Parsons*, 75 W. Va. 793, 84 S. E. 885.
[10] §122.

If, however, the instrument is later negotiated to a holder in due course without notice, the renunciation will not affect his rights. Nor is the instrument discharged when there is not clearly an absolute and unconditional renunciation. Thus a mere refusal of a tender by a joint maker or a release of one joint maker has been held to be an insufficient renunciation.[11] Although the usual concept of the term *renunciation* is a gratuitous surrender of a claim, the term has also been applied to a purchased relinquishment, such as an accord and satisfaction.[12]

Cancellation. The party who is entitled to enforce payment of an instrument may surrender it to the party liable thereon with the intent to release him from the obligation. This operates as a discharge of the instrument and is known as cancellation. It is a form of renunciation. The Negotiable Instruments Law expressly provides for discharge by the "intentional cancellation thereof by the holder." [13] Cancellation need not be made by surrender; it may be accomplished by any act which shows an intent to cancel the obligation. Thus it may be made by intentionally tearing an instrument into pieces and throwing them into discard.[14]

> Holding that the intentional burning of a note discharged the instrument, the court declared: "We find that the cases uniformily hold that the destruction by the donor of the evidence of the indebtedness with the intention to make a gift to the debtor is a sufficient forgiveness of the debt." (Henson v. Henson, 151 Tenn. 137, 268 S. W. 378)

A cancellation is not effective when it is made without the authority of the holder, or when it is made unintentionally or by mistake. The Negotiable Instruments Law provides, however, that "where an instrument or any signature thereon appears to have been cancelled, the burden of proof lies on the party who alleges that the cancellation was made unintentionally, or under a mistake, or without authority." [15] In

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[11] *Davis* v. *Gutheil*, 87 Wash. 596, 152 P. 14.
[12] *Ante*, p. 151.
[13] §119—(3).
[14] *Montgomery* v. *Schwald*, 177 Mo. A. 75, 166 S. W. 831.
[15] §123.

any case of cancellation, if such fact is not shown upon the face of the instrument, it is not operative as against a holder in due course.

Alteration. Whether or not an alteration will discharge a negotiable instrument depends upon its nature. If the alteration is immaterial, it has no effect. If it is material, it will discharge the instrument as to all parties liable, except as to the party who has, himself, made, authorized, or assented to the alteration, and subsequent indorsers. The Negotiable Instruments Law makes an exception to this rule, providing that "when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor." [16] The statute makes no provision for alteration by strangers, thus apparently abrogating an American doctrine which declared alterations by strangers to be ineffective. The statute also apparently applies to alterations made innocently, which were formerly excepted from the rule by at least some courts.

> A few states, as in case of West Virginia, require the alteration to be made by the holder, and Illinois requires also that it be made fraudulently. (5 Uniform Laws Annotated, page 585)

An important element of the alteration is materiality. In general an alteration is material when it operates as to change the effect of the instrument. The Negotiable Instruments Law expressly provides that a material alteration consists of any alteration which makes a change in the date; the amount payable, whether principal or interest; the time of payment; the place of payment; the number of parties; the relation of the parties; or the medium or currency in which the instrument is payable. The statute also declares an alteration to be material if it adds a place of payment when none is specified, or makes "any other change or addition which alters the effect of the instrument in any respect." [17]

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[16] §124.
[17] §125.

After a note had been executed, indorsed, and delivered, the maker at the request of the payee, but without the knowledge or consent of the indorser, placed a seal after his signature. This was a material alteration, discharging the indorser. (Baumer v. Du Pont, 338 Pa. 193, 12 A. [2d] 566)

The following alterations have been held to be immaterial: a change in the marginal figures, but not in the sum written in the note; [18] inserting the legal rate of interest in an instrument calling for interest without stating the rate; [19] and changing "I promise" to "We promise" in a note signed by two makers.[20] In these cases there was no change in the legal import of the instruments.

QUESTIONS

1. McDowell was the indorser of a note. Upon dishonor of the instrument by nonpayment, McDowell paid the amount thereof to Mitchell, the holder. Thereafter McDowell brought an action on the note against the maker. It was contended that the instrument had been discharged. Do you agree?

2. Merle Crawford, the holder of a draft that had been dishonored by nonpayment, resorted to the drawer and received payment. Thereafter the drawer transferred the instrument to Pangburn. Later Pangburn brought an action on the draft to recover from the indorser who transferred the instrument to Crawford. Was he entitled to do so?

3. Hawkins presented a note for payment to the maker, Atwood. Because he was unable to meet the obligation, Atwood gave Hawkins a draft for the amount of the note drawn on a third party. When the draft was not paid at maturity, Hawkins brought an action on the note against Atwood. Was he entitled to judgment?

4. Clossey is the holder of a note made by Chadwick, which is due and unpaid. The former meets the latter on the street and says, "I hereby release all claims against you on your note which I have in my safe." Later Clossey brings action against Chadwick on the note. Can he collect?

5. Maule writes Bordeel that he releases all claims against him on a note which is not yet due. Later Maule negotiates the instrument to Henrotin, a holder in due course. The latter sues Bordeel on the note. Will Bordeel have to pay?

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[18] *Prudential Trust Co.* v. *Coghlin*, 249 Mass. 184, 144 N. E. 283.
[19] *Haas* v. *Commerce Trust Co.*, 194 Ala. 672, 69 S. 894.
[20] *Stanley* v. *Davis*, 32 Ky. L. 1135, 107 S. W. 773.

6. "A negotiable instrument in some instances may be discharged in the same way as a simple contract for the payment of money." What is meant by this statement?

7. A note payable on September 16 is indorsed to the maker on September 2 of the same year. May the maker further negotiate the instrument?

8. Redman executes a note for five hundred dollars, payable to Caughey. The latter raises the amount to five thousand dollars and negotiates it to Ballou. Ballou indorses the instrument to Macomber, a holder in due course. Macomber brings an action to recover the amount of the note from the maker. Is he entitled to judgment?

9. Pingry is the holder of a promissory note payable to the First National Bank of a given city. He changes the word "First" to "Second" because he knows that the maker does most of his business at the Second National Bank of that city. When he is sued on the note, the maker pleads that the instrument was discharged by alteration. Do you agree?

10. John Helm executed a note payable on the following August 28. He purchased the instrument from the holder thereof on August 2. On August 10 he indorsed the note to Forbes. In an action brought by Forbes on the note, it was contended that Forbes could not have received the instrument by negotiation. Do you agree?

11. A note executed by McElroy is overdue. The latter, seeing the instrument on the desk of the holder, appropriates it. When the holder brings an action, McElroy contends that the note is discharged. Is his contention sound?

CASES FOR REVIEW

1. The Florida Power & Light Company drew its check on the Bank of Bay Biscayne in favor of the Cocoa Beach Casino Corporation and, before delivery to the payee, caused the check to be certified. The payee indorsed the instrument to the Brevard County Bank & Trust Company. Payment of the check was refused. Peter Tomasello, as liquidator of the Brevard Bank, brought an action against the drawer of the check to recover thereon. As a defense the Florida company set up the fact that the check had been certified. Was this a valid defense? (Florida Power & Light Co. v. Tomasello, 103 Fla. 1076, 139 S. 140)

2. Norris S. Lippitt and others, bank commissioners, instituted proceedings against the Thames Loan & Trust Company. The receiver of the defendant company sought the advice of the Supreme Court of Errors in respect to certain questions, one of which concerned the type of an indorsement. The National Reserve Bank of New York had sent to the Thames Loan & Trust Company two negotiable instruments

indorsed "for collection and remittance." What kind of indorsements were they? (Lippitt v. Thames Loan & Trust Co., 88 Conn. 185, 90 A. 369)

3. On March 25 the firm of H. & J. Friedman executed and delivered a check, payable to the order of P. E. Kramer. The check was dated April 1 of the same year. Kramer indorsed the instrument to the Currie-McGraw Company. When payment of the check was refused, the Currie-McGraw Company brought an action against the H. & J. Friedman firm to recover on the instrument. It was contended that the check was nonnegotiable. Do you agree with this contention? (Currie-McGraw Co. v. H. & J. Friedman, 135 Misc. Rep. 701, 100 S. 273)

4. Lewis Campbell executed a note for the sum of $10,000, payable to his own order, and indorsed the instrument to the Franklin Operating Company. Horace Fehr received the note, indorsed by Solon A. Stein, president of the Franklin Operating Company, in payment of Stein's personal obligation to him. Fehr brought an action to recover on the instrument from Campbell, who set up fraud as a defense. Was Fehr entitled to judgment? (Fehr v. Campbell, 288 Pa. 549, 137 A. 113)

5. J. S. Basnight executed and delivered two promissory notes, each for the sum of $500, payable to the order of H. W. Steinhilper. Thereafter Steinhilper transferred the notes for value to his wife, but he did not indorse the instruments. In an action brought against Basnight to recover on the notes, it was contended that the instruments had not been negotiated by Steinhilper to his wife. Do you agree? (Steinhilper v. Basnight, 153 N. C. 293, 69 S. E. 220)

6. The Michigan-Arkansas Oil Corporation executed a note for the sum of $2,500, payable to the order of the First National Bank of Ludington, Michigan. Before delivery of the instrument to the payee, the note was indorsed in blank by Downs and Moore. The note was dishonored by nonpayment on January 2, and notice of dishonor was mailed on January 4 to Downs and Moore. Thereafter the payee bank brought an action against the oil corporation and the indorsers to recover on the note. Was it entitled to judgment against Downs and Moore? (First Nat. Bank v. Michigan-Arkansas Oil Corporation, 231 Mich. 597, 204 N. W. 719)

7. J. C. Slack drew a draft for the sum of $150 on the managers of the Clayton Drug Company, Bushnell and his brother, of Clayton, New Mexico. Slack delivered the instrument to the Clayton Town-Site Company. The draft was orally accepted. Subsequently the Clayton Town-Site Company brought an action against the Clayton Drug Company and others to recover on the acceptance. Was it entitled to judgment? (Clayton Town-Site Co. v. Clayton Drug Co., 20 N. M. 185, 147 P. 460)

8. The De Beck Plate Glass Company executed and delivered a check to the Walls Bros. Company. The instrument was made payable to

"Cash." Thereafter the check came into the hands of Frances A. Cleary, who, after payment thereof had been refused, brought an action against the De Beck Plate Glass Company to recover on the instrument. It was contended that the check was not a negotiable instrument. Was this contention sound? (Cleary v. De Beck Plate Glass Co., 54 Misc. Rep. 537, 104 N. Y. S. 831)

9. J. W. Jones, of Seattle, Washington, drew a check on the Peoples' Bank & Trust Company, payable to the order of E. P. Fick. The instrument was transferred to Nellie M. Fick. Without presenting the check to the bank for payment, Mrs. Fick demanded payment thereof by the drawer. When Jones refused to pay the amount of the instrument, Mrs. Fick brought an action against him to recover on the instrument. Was she entitled to judgment? (Fick v. Jones, 185 Wash. 365, 55 P. [2d] 334)

10. A draft for the sum of $84.96, payable to the order of Bailey & Company, was drawn on the Southwestern Veneer Company by I. W. Saxon. The draft was immediately presented for acceptance. The instrument was not accepted but was thrown by the drawee into a wastebasket and later consumed by fire. Thereafter Bailey & Company brought an action against the Southwestern Veneer Company to recover on the instrument. Was it entitled to do so? (Bailey & Co. v. Southwestern Veneer Co., 126 Ark. 257, 190 S. W. 430)

11. The Donald Drug Company executed a note for the sum of $225, payable to the order of the Partin Manufacturing Company. The note was indorsed before maturity to the Commercial Security Company. At the time of such negotiation the note apparently had been altered by certain printed portions being stricken out and other words written in the instrument. The Commercial Security Company brought an action against the Donald Drug Company, which set up as a defense fraud on the part of an agent of the payee. Was the plaintiff entitled to judgment? (Commercial Security Co. v. Donald Drug Co., 115 S. C. 48, 104 S. E. 312)

12. B. S. Davis and others executed and delivered a promissory note, payable to "Vincent Mercantile Company or bearer." The note was transferred by delivery to E. E. Florey and T. C. Florey without being indorsed. When an action was brought by the Floreys to recover on the note from the makers, it was contended that the instrument had not been negotiated. Was this contention sound? (Davis v. Florey, 16 Ala. A. 264, 77 S. 413)

13. A Mrs. Gardner executed and delivered to Frank S. Mason a negotiable promissory note for the sum of $300. She did not owe any debt to Mason for money lent or for services rendered, but she made the note merely out of friendship. Thereafter Mason brought an action against Charles L. Gardner, as executor of the estate of Mrs. Gardner, to recover on the instrument. Was he entitled to judgment? (Mason v. Gardner, 186 Mass. 515, 71 N. E. 952)

14. Emma C. Hannen executed a promissory note with the payee and the amount left blank. She gave the instrument to George L. Hannen who thereafter had an officer of the Peoples' State Bank fill in the blanks. The Peoples' State Bank was made the payee and the amount of the instrument was made $8,325. The amount filled in by the officer of the bank at Hannen's request was not authorized by Mrs. Hannen. After maturity of the instrument the bank brought an action against Mrs. Hannen to recover the amount of the note. Was it entitled to judgment? (Hannen v. Peoples' State Bank, 195 Ky. 58, 241 S. W. 355)

15. Richard S. Walters drew a draft on Townsley & Company, of New Orleans, Louisiana. The instrument was payable at a specified date to the order of Joseph K. Sumrall. In an action brought by Sumrall against Townsley & Company, a question arose as to whether the foregoing draft had to be presented for acceptance. What is your opinion? (Townsley v. Sumrall, 2 Pet. [U. S.] 170, 7 L. Ed. 386)

16. S. J. Eassy drew a check, payable to the order of one Mavidone, and then stopped payment of the instrument. Mavidone negotiated the check for value to J. K. Manos. Without presenting the instrument to the bank for payment, Manos brought an action against Eassy to recover on the check. Was he entitled to judgment? (Manos v. Eassy, 124 S. C. 154, 117 S. E. 222)

17. John J. Forrest executed a negotiable promissory note, payable to the order of the Partin Manufacturing Company. He showed the note to an agent of the payee company and left the room without delivering the instrument. After the agent had left, Forrest discovered that the note was missing. The instrument was negotiated by the payee to C. B. Ensign & Company, who brought an action to recover on the note as a holder in due course. Was Forrest liable on the note to C. B. Ensign & Company? (C. B. Ensign & Co. v. Forrest, 251 Mass. 296, 146 N. E. 655)

18. The American Telephone & Telegraph Company executed an instrument whereby it promised to pay the sum of $1,000 or, at the option of the holder, to deliver its equivalent in stock of the corporation. The holder of the instrument, Helen W. Pratt, brought an action against Henry L. Higginson and others who purchased the instrument from one allegedly a wrongful possessor thereof. It was contended that the instrument was nonnegotiable. Do you agree with this contention? (Pratt v. Higginson, 230 Mass. 256, 119 N. E. 661)

19. The Blue Ribbon Garage was the holder of a promissory note that was executed by the State of Maine Lumber Company, payable to the order of Atwater. The instrument was indorsed by Atwater, by three other persons, and then by R. L. Baldwin who transferred the note to the holder in part payment of the price of an automobile. When the note was dishonored, the holder gave notice of the dishonor by telephone to Baldwin. In an action brought by the garage to recover from Baldwin as an indorser, it was contended that notice of dishonor had not

been properly given. Do you agree? (Blue Ribbon Garage v. Baldwin. 91 Conn. 674, 101 A. 83)

20. The American Tool & Machine Company executed a promissory note for the sum of $1,801.65, payable to the order of the Lancaster Foundry Company. After the note was indorsed by Harry L. Robinson for the accommodation of the maker, the instrument was delivered to the payee. A demand for payment of the note was made by telephone. After giving notice of dishonor, the foundry company brought an action to recover from Robinson as an indorser. Was it entitled to judgment? (Robinson v. Lancaster Foundry Co., 152 Md. 81, 136 A. 58)

21. Martin E. Foyer was the bona fide holder of a check drawn on the account of Sarah G. Keenan with the Guaranty Trust Company of New York. He presented the check to the trust company, received payment, and deposited the proceeds in an account with the Peoples' Trust & Guaranty Company of Hackensack, New Jersey. Thereafter Bessie Gender attached the money deposited by Martin. The Guaranty Trust Company claimed the deposit on the ground that it was paid to Martin on a forged check. The rights of the Guaranty Trust Company were the same as though it had accepted the instrument. Was it entitled to judgment? (Peoples' Trust & Guaranty Co. of Hackensack v. Gender, 119 N. J. Eq. 249, 182 A. 25)

22. E. J. Boebeeg drew a check for the sum of $199.64 on the Merchants' National Bank of New York. The check was payable to the order of Albert E. Jordan. A clerk employed by the payee stole the instrument, indorsed the payee's name, and deposited the check to his account in the Main Street Bank. The check was then indorsed to the Planters' National Bank of Richmond, Virginia. When the forgery was discovered, the Planters' National Bank brought an action to recover from the Main Street Bank. Was it entitled to judgment? (Main Street Bank v. Planters' Nat. Bank, 116 Va. 137, 81 S. E. 24)

23. O. J. Tagley and others signed a negotiable promissory note payable to the order of Clancy Bros., to whom they delivered the instrument on condition that certain other persons sign the note. Clancy Bros., without obtaining the signatures of the other persons, negotiated the note to the Yellow Medicine County Bank, a holder in due course. Thereafter the bank brought an action against the makers to recover on the note. Was the bank entitled to judgment? (Yellow Medicine County Bank v. Tagley, 57 Minn. 391, 59 N. W. 486)

24. Hugh Blackman induced Spies to take out a policy of insurance. He received from Spies a promissory note for the sum of $268. The note was payable to the order of the Royal Mutual Life Insurance Company or Hugh Blackman. The Union Bank of Bridgewater purchased the note from Blackman, who indorsed and delivered the instrument to the bank. Spies later sought to evade payment of the note on the ground of fraud, contending that the instrument was nonnegotiable. Do

you agree with this contention? (Union Bank of Bridgewater v. Spies, 151 Iowa 178, 130 N. W. 928)

25. Giuseppe Termini drew a check payable to the order of A. Bolognesi & Company. The payee indorsed the check for collection to the Mechanics & Metals National Bank of the city of New York. When payment of the check was refused, the bank brought an action in its own name against the drawer of the check. Was it entitled to do so? (Mechanics & Metals Nat. Bank v. Termini, 117 Misc. Rep. 309, 191 N. Y. S. 334)

26. Stephen E. Chaffee was the holder of a note, payable four years from date. He transferred the instrument by blank indorsement to F. H. Bardshar. The note was not paid at maturity. Without presenting the instrument to the maker for payment or giving notice of dishonor to Chaffee, Bardshar brought an action to recover from Chaffee as an indorser. Was he entitled to judgment? (Bardshar v. Chaffee, 43 Wash. 698, 156 P. 388)

27. The Wapinitia Irrigation Company issued some instruments, containing promises to pay certain sums of money, executed by an appropriate officer of the company, E. E. Miller, Treasurer. When Florence L. Toon brought an action against the company to recover on one of the instruments, the company contended that the instruments were not valid because the signature of the treasurer was merely a printed signature. Was this contention sound? (Toon v. Wapinitia Irr. Co., 117 Oreg. 374, 243 P. 554)

28. G. R. Woods, Ed Semke, and others executed and delivered a promissory note payable to the order of the Lowell-Woodward Hardware Company, which described itself as a Colorado corporation. The note was not paid at maturity, and an action was brought to recover thereon. As a defense it was alleged by the makers that the payee was not in truth a corporation. Was this a valid defense? (Lowell-Woodward Hardware Co. v. Woods, 104 Kans. 729, 180 P. 734)

29. E. L. Crumpler, who was engaged in farming in North Carolina, drew a draft on Eure & Company, commission merchants of Norfolk, Virginia. Thereafter W. M. Jones brought a garnishment proceeding against Crumpler, Eure & Company, and others. The Citizens' Bank of Windsor, holder of the draft, intervened to assert a claim based upon the draft. It was contended that Eure & Company, although not having accepted the draft, was liable thereon to the bank. Do you agree? (Jones v. Crumpler, 119 Va. 143, 89 S. E. 232)

30. H. W. Sullivan and H. J. Sullivan executed and delivered to the Springfield Shingle Company a promissory note for the sum of $400. The note contained the following statement: "This note is given to take up the freight and rehandling of N. P. Car 43607 and proceeds from the resale of said car shall apply on this note No. 22438." In an action brought by the First National Bank of Snohomish, the holder of

the note, it was contended that the instrument was nonnegotiable. Do you agree with this contention? (First Nat. Bank of Snohomish v. Sullivan, 66 Wash. 375, 119 P. 820.

31. Kanuth, Nachod & Kuhne, of New York City, drew a draft in favor of Mrs. E. Utassy. The instrument was drawn on the Wiener Bank Verein of Vienna. When the draft was dishonored by nonpayment, the holder, Louis Casper, without protesting the instrument, brought an action to recover from Percival Kuhne and others, who drew the draft. Was he entitled to judgment? (Casper v. Kuhne, 79 Misc. Rep. 411, 140 N. Y. S. 86)

32. The Philadelphia Wholesale Drug Company was the drawee of a draft that had been drawn by Reolo, Incorporated. It accepted the instrument as follows: "Accepted for payment as per Reolo contract for amount and date shown hereon." When the International Finance Corporation brought an action against the drug company, it was contended that the acceptance was a qualified acceptance. Was the contention sound? (International Finance Corp. v. Philadelphia W. Drug Co., 312 Pa. 280, 167 A. 790)

33. J. W. Hiles, of Gothenburg, Nebraska, executed and delivered to his sister, F. E. Keeler, a check for the sum of $5,000. The instrument was made payable one day after the death of Hiles. When the instrument was presented as a claim against the estate of J. W. Hiles, an objection to its payment was entered by Harry W. Hiles. It was contended that the instrument could not be treated as negotiable paper because of its time of payment. Do you agree? (Keeler v. Hiles' Estate, 103 Nebr. 465, 172 N. W. 363)

34. Frank M. Engle, who was engaged in business under the name of F. H. Wright Farm Loan Company, indorsed a certificate of deposit to Fred G. Dennis, who in turn indorsed the instrument to G. O. Shepherd. The certificate was not presented for payment because the issuer, the Commercial Bank of El Reno, Oklahoma, had become insolvent and was in the hands of a liquidating agent. In an action brought by Shepherd against Engle to recover on the instrument, Engle contended that he had no liability because the instrument had not been presented for payment. Do you agree? (Engle v. Shepherd, 100 Okla. 200, 229 P. 208)

35. Oren Curtis, a minor, executed and delivered a promissory note for the sum of $347.30 to the Blanks Motor Company in part payment for a secondhand automobile. The Blanks company negotiated the instrument by indorsement without recourse to the Commercial Credit Company, of New Orleans, Louisiana. When Curtis avoided payment of the note, the Commercial Credit Company brought an action to recover from the Blanks Motor Company. Was the Commercial Credit Company entitled to judgment? (Commercial Credit Co. v. Blanks Motor Co., 174 Ark. 274, 294 S. W. 999)

36. F. L. Granger and L. R. Cottrell were partners, engaged in business under the firm name of "The Oregon Locators." Granger, for partnership purposes, gave to George L. Masten a promissory note for the sum of $100 that was signed "The Oregon Locators." In an action brought by the holder of the note against the partners to recover on the instrument, it was contended that the note was not validly signed. Was this contention sound? (Frazier v. Cottrell, 82 Oreg. 614, 162 P. 834)

37. W. E. Page executed a promissory note for the sum of $535.96, payable to the order of L. B. Coleman. No time for payment was designated in the instrument. It was contended that the note was payable on demand. Do you agree? (Coleman v. Page's Estate, 202 S. C. 486, 25 S. E. [2d] 559)

38. A cashier's check for the sum of $1,200 was made payable to the order of H. C. Barton. During subsequent litigation, it was contended that Barton acquired no rights upon the check until the instrument had been delivered to him. Was this contention sound? (Gallup v. Barton, 313 Mass. 379, 47 N. E. [2d] 921)

39. F. P. Rheinfrank and wife executed a promissory note, payable to the order of F. J. Stowe and wife. In an action brought to recover on the note, it was contended that a pre-existing indebtedness was sufficient consideration to support the instrument. Do you agree with this contention? (Gottesman v. Rheinfrank, 303 Mich. 153, 5 N. W. [2d] 701)

40. L. A. Miller was an indorser of a check for the sum of $100, drawn by Captain H. I. Humphrey, at Camp Shelby. The signature of the payee had been forged by a person who had stolen the instrument. The indorsee to whom Miller had transferred the check sought to hold Miller liable. Was Miller liable to his indorsee? (Citizens' Bank of Hattiesburg v. Miller, 194 Miss. 557, 11 S. [2d] 457)

41. A promissory note executed by P. J. Wollerheim, containing an obvious alteration, was transferred by the payee to a bank. After maturity of the instrument, the note was transferred by the bank to J. M. Balliet. Could either the bank or Balliet hold the maker for the original tenor of the instrument? (Balliet v. Wollerheim, 241 Wis. 536, 6 N. W. [2d] 824)

42. An action was brought by the payee to recover on a promissory note. The makers proved that the note had been delivered with the understanding that it would not be a valid obligation unless and until the assets of a specified estate should be a certain value. They also proved that this event had not happened. Was this a valid defense? (Buellesfeld v. Carpenter, 191 Okla. 301, 129 P. [2d] 1022)

CHAPTER V

PRINCIPAL AND SURETY

Part I—General Considerations

Introduction. The person who seeks to borrow money, to obtain goods on credit, or to construct a building is often required to produce another person who will assume a personal liability as security for the payment of the loan or the purchase price or for the performance of the promised acts. This undertaking whereby a third person makes himself liable to the creditor for the obligation of a principal debtor is known as *personal suretyship.*[1]

The relation of suretyship is one of the most common as well as useful credit devices employed in the business world today. Since the party who needs and demands credit is the one who must furnish security therefor, the relation is primarily a credit device. From the point of view of the creditor or the party to whom an obligation is due, however, the relation is that of a risk-bearing device, particularly when the security is given after a debt or obligation has been created.

The relation of suretyship is of ancient origin and has been used as a credit device since very early times. The principles governing the relation are accordingly clearly defined and more or less settled. It may be said in passing that courts, generally speaking, are inclined to favor the person who undertakes to answer for the obligation of another. This is illustrated by the rule that contracts establishing the relation are strictly construed against the creditor. Courts have also given to the surety a cloak of protection consisting of certain rights and remedies. It is for an appreciation of these rights and remedies that one engaged in business should have some knowledge of the principles and rules governing suretyship.

Definition. A relation based upon a valid contract, whereby one person is answerable for the performance of another's

[1] This type of suretyship should be distinguished from *real suretyship,* which includes the relations of pledgor and pledgee and of mortgagor and mortgagee. These relations are discussed in Chapter VII, Part III, and in Chapter XIV.

obligation to a third person, such as the payment of money or the performance of an act, is known as *suretyship.* The party responsible for the debt or obligation of another is called the *surety.* He is also under certain circumstances called the *guarantor.*[2] The one for whose debt or obligation the surety or guarantor promises to answer is described as the *principal* or *principal debtor,* or the *debtor.* The party to whom the debt or obligation is due is described as the *creditor* or the *obligee.*

> The National Sales Company sold H. Manciet and another materials for carrying out a scheme to increase business. It agreed that if the buyers' business did not amount to a specified sum, it would pay the deficiency. This was not a contract of suretyship. (National Sales Co. v. Manciet, 83 Oreg. 34, 162 P. 1055)

One of the two distinguishing characteristics of the relation of suretyship is that of security for another's debt or obligation. The kind of contract is immaterial so long as it establishes an obligation on the part of one person as security for the obligation of another. To illustrate, the comaker of a promissory note as an accommodation for the other maker is a surety.[3] The relation of suretyship must, however, appear on the face of the instrument or be brought to the attention of the payee in order to entitle the surety to protection under the rules governing suretyship.

> "Suretyship is the lending of credit to aid a principal who has not sufficient credit of his own." (Rollings v. Gunter, 211 Ala. 671, 101 S. 446)

Another feature of the relation of suretyship is the right of indemnity existing between the surety and the principal debtor. Unless the former can claim indemnity from the latter, the relation of suretyship does not exist. An illustration is found in the relation of insurer and insured where the right does not exist. If a creditor takes out insurance against loss as a result of a default of a debtor, and the insurance company is required to pay on the policy, the latter has no right of in-

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[2] *Post,* p. 365.
[3] *Stevens* v. *Oaks,* 58 Mich. 343, 25 N. W. 309.

demnity against the debtor. Certain forms of insurance, however, such as fidelity insurance, closely resemble suretyship.

Classification. Suretyship, as defined in its broad sense, is usually divided, according to the nature of the obligation involved, into two classes. One class is known as strict suretyship, and the other as guaranty.

Strict Suretyship. This term is ordinarily employed to designate the relation where the liability of the promisor is coextensive with the liability of the principal and is therefore primary. For example, if one person signs as the comaker of a note with another, as an accommodation for the latter, or joins the latter in promising to pay for an automobile which the latter desires, he is a surety in the strict sense.[4]

> "A 'contract of suretyship' is where one lends his credit by joining in the principal debtor's obligation, so as to render himself directly and primarily responsible with him, and on the same contract, and without any reference to the solvency of the principal." (Etheridge v. W. T. Raleigh Co., 29 Ga. A. 698, 116 S. E. 903)

Guaranty. If the relation is such that the liability of the promisor is collateral or secondary, and not primary, it is known as guaranty. To illustrate, when a person promises to pay for a car, in the event that another defaults in making payment, he is called a guarantor.[5]

> "A contract of guaranty is distinguishable from one of surety, in that the former is an independent contract, whereby the promisor is bound independently of the person for whose benefit it is made." (Emerson-Brantingham Implement Co. v. Raugstad, 6[illegible] Mont. 297, 211 P. 305)

The position of the strict surety and the guarantor are identical in that both are answerable for the debt or obligation of another, and both are collaterally liable in so far as the principal is concerned. On the other hand, there are several distinguishing features which at times are important. Since the terms *surety* and *guarantor* are often used interchange-

[4] *Kirby* v. *Studebaker*, 15 Ind. 45.
[5] *Guaranty Trust Co.* v. *Koehler*, 187 F. 192.

ably, it must be remembered that the surety undertakes to pay or to perform the obligation for which the principal is also bound. He is therefore under a primary liability to the creditor or obligee. The guarantor does not make a promise similar to the promise of the principal. His promise is to pay or to perform the obligation only in the event of a default by the principal. It is a different obligation, creating a liability collateral or secondary to that of the principal obligor. The difference is also important in respect to the question of notice by the creditor of his acceptance of the offer to answer for the debts of another, and, in some instances, of notice by the creditor of default on the part of the principal.[6]

Kinds of Guaranties. Guaranties may be divided into different kinds, depending upon the nature of the contract establishing the relation.

Guaranties Classified in Terms of the Liability Incurred.

Absolute Guaranty.[7] An unconditional promise to pay or to perform an obligation in the event the principal fails to pay or to perform is an absolute guaranty. By way of illustration, one signing the following statement on a note: "I guarantee payment of this obligation," makes an absolute guaranty.[8] It is presumed that a guaranty is absolute unless its terms indicate otherwise. Absolute guaranties, however, are usually made as to the payment of money.

> "An 'absolute guaranty' is one by which the guarantor is bound immediately upon the principal failing to perform his contract without further condition to be performed." (Cownie v. Dodd, 167 Iowa 627, 149 N. W. 904)

Conditional Guaranty. If by the terms of the contract the amount or the time of payment is uncertain, or if the liability of the promisor depends upon some contingency, the relation created is a conditional guaranty. For example, a

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[6] *Post*, pp. 372 to 374.

[7] It should be noted that the term "absolute" is used to mean only that there is no condition to liability other than failure of the principal to pay or to perform. It does not mean that the guarantor may not use such defenses as are discussed in Part IV.

[8] *Dickerson* v. *Derrickson*, 39 Ill. 574.

person writes the following: "I will pay the note provided you cannot collect it." This is a conditional guaranty because, in order that the liability of the promisor be fixed, an attempt must be made to collect from the maker.[9]

> "A conditional guaranty is 'an undertaking to pay if payment cannot, by reasonable diligence, be obtained from the principal debtor.'" (Beardsley v. Hawes, 71 Conn. 39, 40 A. 1043)

Guaranties Classified in Terms of the Parties to Whom They Are Made.

General Guaranty. When the offer of a promise to answer for the debt or obligation of another is made to the public generally, the promise is a general guaranty. To illustrate, a person indorses a note in this manner: "I hereby guarantee the payment of the within note." In this case the promise can be enforced by anyone taking the instrument on faith of such statement.[10]

> "A general guaranty is one open to acceptance by the public generally." (Jobes v. Miller, 201 Mo. A. 45, 209 S. W. 549)

Special Guaranty. When the offer of a promise to answer for the debt or obligation of another is made to a specified person, the promise is a special guaranty. Only the party to whom the offer is made can accept it. Thus, if the offer is made to one person, and the partnership of which he is a member acts on it, the firm cannot hold the promisor liable as a guarantor.[11]

> "A special guaranty is limited to the person to whom it is addressed." (Tidoute Sav. Bank v. Libbey, 101 Wis. 193, 77 N. W. 182)

Guaranties Classified in Terms of the Extent to Which They Are Limited.

Continuing Guaranty. This type of guaranty occurs when the guarantor contemplates successive obligations to be in-

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[9] *Ordemon* v. *Lawson*, 49 Md. 135.
[10] *Waldron* v. *Harring*, 28 Mich. 493.
[11] *Barns* v. *Barrow*, 61 N. Y. 39.

curred by the principal in reliance on his promise. Thus, if the promisor engages to answer for the payment of as many automobiles as another desires to purchase, the promise is a continuing guaranty.[12]

> "The complaint alleges that the guaranty was to cover loans then purchased and subsequently to be purchased. Therefore the complaint alleges it was a continuing guaranty." (Hirning v. Jacobsen, 51 S. D. 270, 213 N. W. 505)

Limited Guaranty. This type of guaranty occurs when the promise is limited to a certain period, or when it specifies the maximum amount for which the guarantor will become liable.

Unlimited Guaranty. When no time is fixed during which the relation is to exist and no limit set on the amount of the guarantor's liability, the promise is an unlimited guaranty.

Creating the Relation. The relation of suretyship is generally created by a contract entered into for that purpose. In some instances, however, the relation is said to be the result of the operation of law. This occurs when the result of a contract for some other purpose makes one party secondarily liable for the obligation of another. For example, it has been held that if a mortgagor conveys the mortgaged premises, and the grantee assumes the mortgage debt, the grantor who was the original debtor is now in the position of surety as to the grantee.[13]

> "One who furnished collateral as an accommodation to secure the loan to another stands in the relation of surety to the one accommodated." (Eberhart v. Eyre-Shoemaker, 78 Ind. A. 658, 134 N. E. 227)

In all cases the relation is based upon an agreement, the validity of which is governed by the principles of simple contracts. There are, however, a few points in connection with the elements of an enforceable agreement which should be noted in respect to the relation of suretyship.

Consideration. The relation of suretyship may be established on an agreement made before, after, or contemporane-

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[12] *Tischler* v. *Hofheimer*, 83 Va. 35, 4 S. E. 370.
[13] *Hein* v. *Vogel*, 69 Mo. 529.

ously with the principal obligation. In all cases there must be a consideration to sustain the promise of the surety or guarantor. If the promise is made after the principal's obligation, a separate consideration is necessary; but a separate consideration is not necessary when it is made before or at the same time. Thus, when a person agrees to be a guarantor at the time the debtor borrows a sum of money, the loan by the creditor is sufficient consideration for the promises of both the principal and the surety.[14]

> H. O. Pickens executed and delivered a promissory note. The payee thereafter obtained the promise of Bessie Pickens as surety. No liability was created because of lack of consideration. (State Bank v. Pickens, 117 Kans. 701, 237 P. 651)

Concealment. A form of fraud frequently accompanying suretyship arises in respect to the concealment of facts by the creditor. Although the relation of suretyship requires utmost good faith and fair dealing between the creditor and the surety, it is not necessary that the creditor inform the surety of every material fact of which he has knowledge. In some situations, however, the nondisclosure of material facts will amount to a fraudulent representation which will entitle the surety to avoid the agreement. One court stated: "I think, both on authority and on principle, that, when the creditor describes to the proposed sureties the transaction proposed to be guaranteed (as in general a creditor does), that description amounts to a representation, or at least is evidence of a representation, that there is nothing in the transaction that might not naturally be expected to take place between the parties to a transaction such as that described. And if a representation to this effect is made to the intended surety by one who knows that there is something not naturally to be expected to take place between the parties to the transaction, and that this is unknown to the person to whom he makes the representation, and that, if it were known to him, he would not enter into the contract of suretyship, I think it is evidence of a fraudulent representation on his part." [15] A sit-

[14] *Lompoc Valley Bank* v. *Stephenson*, 156 Calif. 350, 104 P. 449.
[15] *Lee* v. *Jones*, 17 C. B. N. S. 482.

uation of this kind exists when an employer continues to employ the principal debtor, but fails to tell the surety that the employee is a defaulter, thus representing him to be honest. The rule does not apply, however, if the surety has equal opportunity to discover such facts, unless he inquires about them. To illustrate, the creditor need not disclose that the principal is insolvent.[16]

> E. L. Duchett became surety on a note in which the principal had made a waiver of homestead. The principal and creditor concealed from him a secret agreement for payment of usury which voided the homestead waiver, thus increasing the surety's risk. It was held that Duchett was not liable. (Duchett v. Martin, 23 Ga. A. 665, 99 S. E. 151)

Form of Contract. In some instances the promise of a surety is not enforceable unless it is in writing. Most states have legislation following the provision of the old English Statute of Frauds, which reads: "No action shall be brought whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriage of another person, unless the agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the parties to be charged by such contract, or their agents thereunto lawfully authorized." [17]

It should be noted that the contract establishing strict surety, as defined above, does not come within the provision of the statute. A surety in the strict sense has a primary obligation and does not answer for the obligation of another. The provision refers to a special promise to answer for another's obligation in event of default, and it therefore applies only to that part of suretyship known as guaranty, in which one person agrees to answer for the obligation of another.

QUESTIONS

1. "Suretyship is both a risk-bearing device and a credit device." What is meant by this statement?

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[16] *Ham* v. *Greve*, 34 Ind. 18.
[17] *Ante*, p. 131.

2. Averill agrees to make a loan to Jessup on condition that he is given security in the form of a pledge. Keyes, a friend of Jessup, delivers his watch to Averill as security for payment of the loan. Is this transaction known as personal suretyship?

3. Baldwin, after constructing a new suburban home, entered into an agreement with the National Beneficial Company. The company promised to indemnify Baldwin against a loss resulting from the destruction of the house by fire. In an action brought by Baldwin against the company, it was contended that the foregoing agreement created the relation of suretyship. Do you agree?

4. Stuhldreher entered The Emporium, a retail clothing store, and selected a suit of clothes. He told the salesman to send the suit to Kendrick and added, "I'll see that you are paid." When an action was brought against Stuhldreher for the purchase price, he contended that he was a surety. Was his contention sound?

5. Atwood wishes to purchase an automobile by paying five hundred dollars down and the balance of one thousand dollars one year later. The seller will not agree to this proposition unless he is given some form of security. Atwood persuades Hamilton to join him in a promise to pay the one thousand dollars on April 10 of the following year. Is Hamilton a guarantor or a strict surety?

6. Alden executed a promissory note payable to the order of the Third National Bank. At the time of the delivery of the instrument to the bank, Stalker gave the bank a writing in which he promised to pay the note if Alden could not pay it. Was Stalker an absolute guarantor?

7. Bradley writes to Cook directing him to advance any amount of money to Andrews for the period of one year and promising to pay the amount of the loans if it cannot be collected from Andrews. What type of guarantee does Bradley make?

8. Dorcas makes a loan of fifty dollars to Kreighton upon Moran's promise as guarantor. When Dorcas brings action against Moran, the latter claims that there is no liability because of lack of consideration for his promise. Is his contention sound?

9. Majors became a surety for an obligation owed by C. N. Busbee to Chadsey. At the time of creating the relation, Chadsey failed to inform Majors of the fact that Busbee was insolvent. When an action was brought by Chadsey against Majors, concealment was set up as a defense. Was Chadsey entitled to judgment?

10. A vendor will not sell a coat on credit to Lebanon unless Halper also promises to pay for it. Halper promises. When Lebanon fails to pay for the coat, the vendor sues Halper. The latter maintains that he is not liable because the agreement was oral. Do you agree?

Part II—Rights and Duties of the Creditor

Notice of Acceptance. In some instances the creditor must give notice to the surety of his acceptance of the offer to answer for the debts of another. Notice of an acceptance of the offer to answer for the obligations of another is not necessary in the absence of a request therefor, if the transaction establishing the relation is such as to show clearly that the offer has been acted upon. For example, if a guaranty is for the performance of the terms of a lease on the part of the lessee and is made part of the consideration for the lease, notice is not necessary.[1] This is equally true if the offer is such as to indicate that reliance upon the offer by the creditor is sufficient. Thus, in case of strict suretyship, notice of acceptance is unnecessary unless required by stipulation.[2] Nor is notice necessary when the surety or guarantor has promised at the request of the creditor or has learned of the acceptance in some manner.

> Notice is not necessary when the creditor is justified in "assuming that notice of his acceptance will be communicated to the surety by the principal." (Restatement, Security, Sec. 86, Comm. c)

In some cases it is held that notice of acceptance is required unless waived by the promisor. "Where the offer is to guarantee a debt for which another is primarily liable, in consideration of some act to be performed by the creditor, mere performance of the act is not sufficient to fix the liability of the guarantor; but the creditor must notify the guarantor of his acceptance of the offer or of his intention to act upon it." [3] This is because the courts infer that the offer contemplates notice of the acceptance. Thus, if the offer is to establish a continuing guaranty, notice of acceptance must ordinarily be given to the guarantor.[4] The requirement of notice is an exception to the general rule governing contracts calling for the doing of the act as an acceptance. The basis for this rule

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[1] *Mitchell* v. *McCleary*, 42 Md. 374.
[2] *Breed* v. *Hillhouse*, 7 Conn. 523.
[3] *Steadman* v. *Guthrie*, 4 Metc. (Ky.) 147.
[4] *Tuckerman* v. *French*, 7 Me. 115.

seems to be mainly that in such cases the knowledge of the act does not come quickly to the promisor, and he should consequently be informed as to this liability so that he may have opportunity to protect himself.

> The doing of the act is the acceptance, creating a contract; the failure to give sufficient notice discharges the duty thereunder. (Restatement, Contracts, Sec. 56, Comm. a)

When notice is necessary, its form is immaterial so long as it indicates with reasonable clearness that the act has been done. The notice must be sent in a reasonably appropriate manner and within a reasonable time after the doing of the act. By way of illustration, it was held that notice given eleven months thereafter was not given within a reasonable time.[5] What amounts to a reasonable manner or time is, however, a question of fact to be determined from the circumstances of each case.

Enforcement Against the Principal. In cases of strict suretyship or of absolute guaranty, the creditor is not required to attempt to enforce his claim against the principal debtor. In these situations the surety has been liable from the time of making the contract, and the guarantor becomes liable immediately upon default of the principal debtor. For example, an undertaking to answer for the debt of another by guaranteeing payment thereof is an absolute guaranty; the guarantor is therefore liable without proceedings having first been made against the debtor.[6]

> "The surety may be sued immediately upon default of the principal and before any proceedings are had against the principal, and the bringing of the suit is demand enough." (Rowe v. Bank of New Brockton, 207 Ala. 384, 92 S. 643)

In other types of guaranty, however, the mere fact of a default on the part of the principal debtor does not as a general rule make the guarantor liable. The creditor in order to fix liability in these types must meet the conditions of the guaranty.

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[5] *Hill* v. *Calvin*, 5 Minn. 231.
[6] *Jackson* v. *Decker*, 14 App. Div. 415, 43 N. Y. S. 957.

Thus, in the case of the guaranty of the collection of a note, the creditor must use reasonable diligence in attempting to collect the note by the legal means ordinarily employed.[7]

> In a case of a guaranty of collection the creditor must "take with reasonable promptness appropriate remedies against the principal." (Restatement, Security, Sec. 130-2)

What constitutes due diligence depends upon the circumstances of each case. Generally speaking, due diligence requires the creditor to make an honest attempt to obtain a judgment and satisfaction thereof within a reasonable time after the obligation is due. Due diligence also requires that the creditor resort to other securities that are available for the performance of the obligation.

> Barrett guaranteed collection of a note made by Adams, which, by indorsement, Clark had guaranteed payment thereof. The holder, having failed to exercise due diligence to collect from Clark as well as Adams, could not hold Barrett. (Summers v. Barrett, 65 Iowa 292, 21 N. W. 646)

The creditor's failure or delay to enforce the claim against the principal does not, generally speaking, discharge the guarantor. It must be shown that such failure or delay has resulted in a loss or injury to the guarantor. In this case the latter is discharged from liability to the extent of such loss. It is probably for this reason that courts sometimes declare that an attempt to enforce the claim against the principal debtor is excused if the attempt would obviously be futile. To illustrate, in almost all jurisdictions the creditor is excused from first pursuing the principal if the latter is insolvent.[8]

Notice of Default. It is usually held that it is not necessary to give notice of the principal's default in strict suretyship and absolute guaranty.[9] Notice may be required, however, by the terms of the contract. In this case notice must be given.

> Notice of principal's default must be given to the surety when it "is required by the terms of the surety's contract." (Restatement, Security, Sec. 136)

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[7] *Dillman* v. *Nadelhoffer*, 160 Ill. 121, 43 N. E. 378.
[8] *Brackett* v. *Rich*, 23 Minn. 485.
[9] *Marsh* v. *Putney*, 56 N. H. 95.

In other types of guaranty the liability of the promisor is conditional; therefore reasonable notice may be required of the creditor. For example, if the promise guarantees the collectability of a debt, the creditor is under a duty to give reasonable notice of his inability to collect by exercising due diligence.[10] Notice may, however, be waived by the guarantor for whose protection it is required.

> In case of a guaranty of collection, the guarantor is not primarily concerned with the default, but is mainly concerned with the inability of the creditor to collect from the principal. (Restatement, Security, Sec. 137, Comm. a)

When notice is required, failure to give such notice or to give it within a reasonable time does not necessarily discharge the guarantor. The creditor's delinquency as to notice merely discharges the guarantor to the extent of the damages actually suffered as a result of his failure to give proper notice. To illustrate, if a debtor is solvent at the time of the default but later becomes partially insolvent, the guarantor, in the event of the creditor's failure to give reasonable notice, is discharged only to the extent of his loss.[11] In this respect the guarantor is in a different position from the indorser who is also a surety. The latter is discharged by failure to give notice, irrespective of damages suffered.[12] If the debtor is insolvent at the time of the default and continues in that state, the guarantor is not discharged, since no damages occur because of failure to give notice.

Securities Held by the Surety or the Guarantor. The principal debtor may transfer to the surety or the guarantor certain property as security against loss. In this event the creditor, after the debt is due, may subject these securities to the payment of the obligation. Equity considers such property to be held in trust, and upon proper showing will enforce the creditor's right to the benefit of it.

The right extends to any property, real or personal, which is given by the principal to the surety or the guarantor as

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[10] *Reeves* v. *Howe*, 16 Calif. 152.
[11] *Newton Wagon Co.* v. *Diers*, 10 Nebr. 284, 4 N. W. 995.
[12] *Ante*, p. 331.

security. To illustrate, the creditor is entitled to enforce promissory notes made by third persons, which are placed in the hands of the surety by the debtor.[13] On the other hand, the creditor is not entitled to the benefit of property in the hands of the surety or the guarantor that has been given as security by third persons. To illustrate, if a partner of the principal debtor gives his property to the surety as security against loss, the creditor cannot reach it.[14] Nor can the creditor reach property given to the surety or the guarantor to be used as indemnity only under certain conditions. His right is no greater than that of the surety or the guarantor; therefore such property is not available until the happening of the contingency. Thus, if the security is given to the surety for the purpose of indemnity only in the event of a judgment rendered against him, the creditor cannot reach the property until that event occurs.[15]

The creditor does not lose his right to the property in the hands of the surety or the guarantor by any wrongful disposition of it, unless rights are created for value in favor of third persons who are without notice. Nor is his right to the benefit of the property affected by the fact that he has lost his right to hold the surety or the guarantor personally. For example, if the claim of the creditor is barred by the Statute of Limitations, he is still entitled to the benefit of the securities held by the surety.[16] The same rule applies when the surety or the guarantor has been released from liability by any act of the creditor or by bankruptcy.

QUESTIONS

1. Coddington refuses to accept a note for six hundred dollars made by Dowling unless Kelham signs the instrument as comaker. Dowling procures the signature of Kelham as comaker for his accommodation, and Coddington accepts the note. When sued on the note, Kelham maintains that he is not liable on the ground that Coddington did not notify him that his offer had been accepted. Is his contention sound?

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[13] *Breedlove* v. *Stump*, 3 Yerg. (Tenn.) 257.
[14] *Amer. Surety Co.* v. *Lawrenceville Cement Co.*, 110 F. 717.
[15] *Pool* v. *Doster*, 59 Miss. 258.
[16] *Ijames* v. *Gaither*, 93 N. C. 258.

2. Wharton writes Duverger, stating, "Let Kedey have as much credit as he wants, and I'll see that you are paid." Duverger extends credit to Kedey for goods amounting to three thousand dollars. When Kedey fails to pay the amount due, Duverger sues Wharton. Is the latter liable for the amount?

3. Mozley wishes to purchase a saxophone on credit. The vendor refuses to sell the article to him unless Todd also promises to pay for it. The latter promises. When action is brought against Todd for the price of the saxophone, he proves that the vendor did not attempt to enforce his claim against Mozley. Is this a valid defense?

4. Laithe guarantees the collection of a note given by Whitley. When the instrument is not paid at maturity, the creditor immediately brings action against Laithe. Is he entitled to judgment?

5. Gunn guarantees the collectibility of a note. At the time of an action by the creditor against Gunn, it is proved that the former did not attempt to enforce his claim against the principal within a reasonable time. How does this fact affect Gunn's liability?

6. Mandelbaum executed a guaranty of the collection of a draft. Corwin, the holder of the instrument, attempted with due diligence to collect on the draft, but he did not give notice of default to Mandelbaum. Could Corwin hold Mandelbaum on the guaranty?

7. Howard gave seven bonds to Breedonis as security against loss as a guarantor of a debt owed by Mills to the National Northern Bank. After exercising due diligence to collect the debt from Mills and giving due notice of the default to Breedonis, the bank sought to subject the bonds to the payment of the debt of Mills. Was it entitled to do so?

8. Cummings executes a note payable to a creditor, and Ruston agrees to be surety. Cummings gives Ruston ten United States bonds valued at one thousand dollars to indemnify him in the event that the creditor secures a judgment against him. The note is not paid by Cummings at maturity and the creditor immediately demands a benefit of the securities in Ruston's hands. Is his claim valid?

9. A principal debtor delivers certain bonds to the surety for purposes of indemnity in the event that the surety is compelled to pay the creditor. The debt is unpaid at maturity, and the creditor seeks to subject the securities in the surety's hands to satisfy the debt. The surety has been judicially declared a bankrupt. How does this fact affect the creditor's interest in the securities held by the surety?

10. Bert Anderson was surety for a debt owed by Farrell to the Southern Milling Company. He was given by Farrell as security against loss a note executed by Brewster and payable to Farrell. The note, which was negotiable, was discounted by Anderson at a bank. When Farrell did not pay his indebtedness, his creditor brought an action against the bank to subject the note given by Farrell to Anderson to the payment of the obligation. Was the creditor entitled to judgment?

Part III—Rights of the Surety and the Guarantor

Exoneration. When the principal debtor has not met his obligation at the agreed time, and when the surety or the guarantor sees that he may be called upon to answer for the obligation, the surety or the guarantor may in some instances call upon another to save him harmless. When it is possible for a surety or a guarantor to require that satisfaction be secured in some way other than by recourse to himself, the surety or the guarantor is said to have a right of *exoneration.*

In the case of strict suretyship or of absolute guaranty, the creditor is under no duty to pursue the principal debtor or resort to property in his hands as security, before seeking payment by the surety. In some instances, however, equity will compel the creditor to resort to the principal or to his property held as security, before he may resort to the surety or the guarantor. This right is only given provided the surety or the guarantor would otherwise suffer a hardship, and provided the right does not cause hardship to the creditor. For example, a creditor who did an act that a court held as rendering void a mortgage that he held as security, which was valid when taken and ample to pay the debt, was compelled, upon indemnity by the surety against the consequences of risk, delay, and expense, to attempt to enforce such mortgage before resorting to the solvent surety.[1] There are statutes in some states which require the creditor to resort to the property of the principal debtor before proceeding against the surety or the guarantor.[2]

> In case of a guaranty of collection, the creditor must enforce his security interest in the property of the principal before proceeding against the guarantor. (Restatement, Security, Sec. 131-2-b)

When the obligation is due, equity may, at the surety's or the guarantor's request, order the debtor to save him harmless by paying the debt. This right is based upon the principle that the principal must protect the surety, and it is available even though the latter is not being molested by the creditor,

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[1] *Hayes* v. *Ward,* 4 Johns. Ch. (N. Y.) 123.
[2] *Johnson* v. *Harris,* 69 Ind. 305.

and though there appears no likelihood of the principal not being able to pay the obligation. For example, it is no defense to this remedy for the principal to prove that he is not insolvent or likely to become so.[3]

> To obtain this remedy, it is not necessary that the surety allege "any particular reason for fearing that he will not be reimbursed in the event of payment." (Restatement, Security, Sec. 112, Comm. a)

The right of exoneration may be exercised in some cases against the cosureties or the coguarantors. These parties, as to each other, are equally liable. When the creditor resorts only to one surety or guarantor, that surety or guarantor may go into equity to compel the cosureties or the coguarantors to pay their share if payment by him alone would work a hardship on him. The right is sometimes given when to require the one surety to pay and then to demand contribution would be too late. To illustrate, where a cosurety fraudulently attempts to dispose of his property to escape liability, equity will allow a bill for exoneration.[4]

Subrogation. The surety or guarantor, after making payment to the creditor, is entitled to an equitable right of *subrogation.* By right of subrogation is meant that the one making payment for another takes the place of the creditor in respect to the obligation of the principal, and is entitled to all rights, securities, and benefits available to the creditor. For example, the surety, after paying the debt, is entitled to subject any stocks or bonds, placed in the hands of the creditor as collateral security, to satisfy his claim.[5] This right is not, however, available to one who is not bound to answer for the principal's debt or obligation, or to one who does not have any interest in the subject matter. To illustrate, if one voluntarily pays another's indebtedness to a creditor who holds certain property as security, he is not entitled to the benefit of this security on the grounds of subrogation.[6] This rule applies even when he erroneously believes that he is a surety.

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[3] *Holcombe* v. *Fetter,* 70 N. J. Eq. 300, 67 A. 1038.
[4] *Smith* v. *Rumsey,* 33 Mich. 183.
[5] *Muller* v. *Wadlington,* 5 S. C. 342.
[6] *Dawson* v. *Lee,* 83 Ky. 49.

> "Subrogation is an equitable doctrine depending upon no contract or privity, and proper to apply wherever persons other than volunteers pay a debt or demand which in equity and good conscience should have been satisfied by another." (Stroh v. O'Hearn, 176 Mich. 164, 142 N. W. 865)

The surety or the guarantor cannot ask for the right of subrogation until the claim of the creditor has been paid in full. The latter is entitled, as a general rule, to hold all securities in his possession so long as some part of the principal's obligation remains unperformed, for which he may need to enforce his securities. To illustrate, a surety who is answerable for one installment of a debt is not entitled to subrogation until all installments have been paid.[7] This is also true if a surety or a guarantor has paid only half of the debt, the remainder being unpaid. He is entitled to such securities, however, when he pays only half of the debt, and the remainder is paid by the principal. In any case the surety or the guarantor is permitted to enforce the right of subrogation only to the extent of his loss. Thus, if the surety settles the debt for less than the amount due, he can reach the securities in the hands of the creditor only to the extent of his loss.[8]

Indemnity. In addition to the right of subrogation, the surety or guarantor has another remedy for reimbursement from the principal. There is an implied contract between the principal and the surety, or guarantor, that the former will indemnify the latter in the event of payment to the creditor. "It is an equitable principle of general application that when one person in the position of a mere surety for another, whether he became so by actual contract or by operation of law, is compelled to pay the debt which the other in equity and justice ought to have paid, he is entitled to relief against the other, who was in fact the principal debtor. And when courts of law, a long time since, fell in love with a part of the jurisdiction of chancery, and substituted the equitable remedy of an action of assumpsit upon the common money counts, for the more dilatory and expensive proceeding by a bill in equity in certain cases, they permitted the person thus

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[7] *Massie* v. *Mann*, 17 Iowa 131.
[8] *Martindale* v. *Brock*, 41 Md. 571.

standing in the situation of surety, who had been compelled to pay money for the principal debtor, to recover it from the person who ought to have paid it, in this equitable action of assumpsit as for money paid, laid out, and expended for his use and benefit." [9] The right of indemnity may, of course, be expressly provided for in the contract.

> A provision in an indemnity agreement that vouchers and other evidences of payments by the surety should conclusively establish the amount of the principal's liability was held to be "reasonable and valid." (American Bonding Co. v. Alcatraz Construction Co., 202 F. 483)

The right of indemnity arises only upon payment by the surety or the guarantor. It follows that the Statute of Limitations does not begin to run against the surety or the guarantor in favor of the principal until payment is made. This should be carefully noted, as the surety or the guarantor may be able to proceed against the principal on an implied contract of indemnity when he cannot resort to subrogation. For example, Curtis is the guarantor of a debt owed by Tanzel to Creel. The Statute of Limitations provides a bar to actions on express simple and implied contracts which are not brought within five years. Two years after the maturity of the debt, Curtis pays the creditor. Four years later he seeks to be subrogated to the rights of Creel by means of subrogation. The right of subrogation is barred since the debt between the creditor and Tanzel is six years overdue. He can, however, sue on the implied contract of indemnity since only four years have run against this claim. "A guarantor, who has become such at the request of the principal, has the benefit of an implied promise of indemnity; and a new and independent cause of action arises thereon whenever he is compelled to make a payment, irrespective of the time of maturity of the original debt." [10]

Contribution. A surety or a guarantor who has paid the creditor may not be able to protect himself either by way of

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[9] *Hunt* v. *Amidon*, 4 Hill (N. Y.) 345.
[10] *Leslie* v. *Compton*, 103 Kans. 92, 172 P. 1015.

subrogation or on an implied contract of indemnity. In such a case, however, he is not entirely without remedy if there are any cosureties or coguarantors, as he may compel them to share the loss. To illustrate, if one of three cosureties for the sum of three hundred dollars is compelled to pay the amount, he is then entitled to one third of the amount, or one hundred dollars, from each of the other cosureties.[11] This remedy is known as a right of *contribution*.

> J. W. Rogers signed a note as surety after another surety, T. G. Reed, stated: "I will guarantee you will not have to pay." It was held that Reed's right of contribution had been destroyed by agreement. (Reed v. Rogers, 134 Ark. 528, 204 S. W. 973)

Contribution is an equitable doctrine which exists in favor of cosureties or coguarantors even in the absence of contract. Although originating in equity, the doctrine was adopted later by common law. There is, however, one important difference in the application of the doctrine in equity and at common law. The common law adopts the plan of requiring each surety to contribute a sum equal to the amount of the liability of all divided by the number of sureties. Thus, if there are four cosureties for a debt of twelve hundred dollars, and one of them is required to pay that sum to the creditor, the latter is entitled at common law to recover three hundred dollars from each of the others.[12] It should be noted that if one of them cannot be found or is insolvent, the surety making the payment to the creditor will suffer a loss of six hundred dollars. In equity, however, the surety or the guarantor who pays the debt is entitled to contributions of sums equaling the total amount of the liability divided by the number of cosureties or coguarantors within the jurisdiction who are solvent. Thus, in the case assumed above, the surety paying the creditor is legally entitled to four hundred dollars from each of two of the cosureties if one of them cannot be found or is insolvent.[13]

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[11] *Nurre* v. *Chittenden*, 56 Ind. 462.
[12] *Fischer* v. *Gaither*, 32 Oreg. 161, 51 P. 736.
[13] *Harris* v. *Ferguson*, 2 Bailey (S. C.) 397.

> It is held by some courts that, in actions at law for contribution, the amount of contribution is determined, as in equity, by the number of solvent sureties, and "that removal from the state is, for this purpose, equivalent to insolvency." (Liddell v. Wiswell, 59 Vt. 265, 8 A. 680)

The surety or the guarantor making payment is entitled to contribution only after making payment in full or settling the debt. He may waive his right to contribution by express agreement or by conduct which in some way would injure the cosureties or the coguarantors. For example, if one surety agrees to extend the time to the principal debtor, he loses the right of contribution against the cosureties.[14] This is equally true when he releases the principal or brings about a default on the part of the principal debtor. If a surety or a guarantor loses or surrenders collateral security in his possession, the liability of the cosureties or the coguarantors for contribution is discharged to the extent of the loss.

QUESTIONS

1. Elmer Hayden was surety for an obligation owed by Nelson to the Bank of Commerce. Nelson failed to pay the debt. Hayden brought a proceeding against the bank for the purpose of compelling the bank to resort to Nelson before seeking payment from him. Was he entitled to judgment?

2. Millington, in the capacity of a surety, joined Mather in the execution of a promissory note. When Mather did not pay the note at maturity, Millington brought suit to compel Mather to save him harmless by paying the obligation. Was he entitled to a decree in his favor?

3. Judd, Blake, and Dunkirk are cosureties for an obligation Blair owes to Dunkirk. At the time of performance it is clearly evident that Blair will be unable to perform. Judd, fearing that Dunkirk will collect the entire amount from him, brings suit to compel his cosureties to pay their share. Is he entitled to do so?

4. Ray M. Rankin guaranteed the payment of a note that was executed and delivered by Stone to the State Trust & Savings Company. Stone was required to deliver certain bonds to the bank as collateral security. Rankin paid the note upon default by Stone. Thereafter he brought an action to obtain the bonds for the purpose of satisfying his claim against Stone. Was Rankin entitled to judgment?

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[14] *Clark* v. *Dane*, 128 Ala. 122, 28 S. 960.

5. A principal was unable to pay an installment of his debt when it was due. Cranby as a guarantor was compelled to pay the amount of the installment. He then demanded the securities in the hands of the creditor, which had been given by the principal to satisfy the debt in case of default. Was he entitled to do so?

6. Chaflin was the guarantor of a note issued by E. I. Berkey to the Traders' National Bank. When Berkey failed to pay the note at maturity, Chaflin was compelled to do so. Thereafter Chaflin brought an action against Berkey, but not on the note, to collect the amount he paid to the bank. Was he entitled to judgment?

7. Stockwell executes a promissory note payable to Fairfax, and Fremont agrees to be surety. Five years after the note is due, the creditor collects the amount from Fremont. Six years later Fremont wishes to collect the money from Stockwell. If the Statute of Limitations on notes is ten years, what are Fremont's rights against Stockwell?

8. James Scott, O. A. Evans, and George Bonner were coguarantors of a note for $1,500 executed by Melton. Evans was compelled upon default of Melton to pay the entire amount of the note. Thereafter, because of the insolvency of Scott, Evans brought an action at law to recover the sum of $750 from Bonner. Was Evans entitled to judgment?

9. Mound, Bachrach, and Risley are cosureties to secure Benner's obligation to pay one thousand dollars. Mound has in his possession stock worth one thousand dollars which Benner delivered to him for purposes of indemnity in the case of loss. Later, at Benner's request, Mound returns the stock to him. Upon Benner's failure to perform his obligation, the creditor collects from Mound. Thereafter Mound brings an action to collect from Risley a third of the amount he paid. Is Mound entitled to judgment?

10. Farrady, Gilmer, and Palmer are cosureties to secure a debt of $3,000 owed by Carrington to Majors. At maturity of the obligation, Majors collected the debt from Gilmer. Thereafter, Gilmer executed a release to Carrington and then demanded $1,000 from each of his cosureties. Farrady and Palmer refused to pay. Were they justified in so doing?

Part IV—Defenses of the Surety and the Guarantor

Ordinary Defenses. Since the relation of suretyship is based on contract, the surety or the guarantor may resort to such defenses as are available to a party under any contract. Thus in some situations a surety or a guarantor may avoid liability on the grounds of incompetency of parties, lack of consideration, lack of real assent (as in the case of fraud, mistake, duress, or undue influence), or lack of the required formality. The surety or the guarantor may also defend on the ground that the contract has been discharged by performance or by agreement. These defenses have been discussed elsewhere and need no elaboration here.[1] However, attention must be given to some defenses peculiar to the relation of suretyship. Some of these have been considered previously.[2] Others will now be considered.

Discharge of the Principal Debtor. The surety or the guarantor engages to answer for the obligation of another. It follows, generally speaking, that when the obligation is extinguished, no liability can be established against the surety or the guarantor.

Payment of the Debt. When the principal debt has been paid, the surety or the guarantor is discharged. It is immaterial whether the payment is made by the principal debtor or by a third party. In the latter case, however, it must appear that the money paid by the third person was in payment of the obligation. For example, the surety is not discharged if the third party pays the amount due for an assignment of the debt.[3] The form of property in which payment is made is immaterial if the creditor accepts it to extinguish the debt.

> If the creditor refuses a tender of payment by the principal, the surety is discharged, because "a party cannot by his own act prevent another from performing his engagement and then complain that he has not kept its stipulations." (Title Guaranty & Surety Co. v. Poe, 138 Md. 446, 114 A. 481)

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[1] *Ante*, Chapter I.
[2] *Ante*, Parts II and III.
[3] *Wright* v. *Yell*, 13 Ark. 503.

Release of the Debtor. If the creditor releases the principal debtor without the consent of the surety or the guarantor, he also usually discharges such parties. Thus, when the creditor covenants not to sue the principal, the surety is discharged from liability.[4] In such a case the act of the creditor precludes the surety or the guarantor from exercising his right of subrogation. The rule does not apply, however, when the rights of the surety or the guarantor have not been affected. Thus, if the creditor when making the release or agreeing not to sue expressly provides that he reserves his rights against the surety, the latter is not discharged.[5] The principal cannot object to reimbursement of the surety or the guarantor in this event because, in accepting the reservation of the creditor, he impliedly consented to payment by the surety or the guarantor.

> Another instance in which a release of the principal by the creditor does not discharge the surety is when "the surety consents to remain liable notwithstanding the release." (Restatement, Security, Sec. 122)

Release of the Debtor by Law. A different rule is applied when the principal is discharged from his obligation by operation of law. "Whenever the inquiry is one of original liability, the surety cannot be held to a greater extent than the principal is bound for. The principal's obligation defines the boundary upward, beyond which the surety's obligation cannot be carried. So, the creditor can do no act by which he reduces the principal's liability without at the same time reducing the surety's liability, at least to the same extent. But the rule is very different where the law reduces or absolves the principal's liability, without fault or procurement of the creditor. In such a case the principal's defense is personal and does not affect or impair the surety's liability, unless he also has a personal defense. Discharge of the principal in bankruptcy, by a statute of limitations, or, if he be dead, by failure to present or file the claim against his estate within the time required by law, are of this class.

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[4] *Farnsworth* v. *Coots*, 46 Mich. 117, 8 N. W. 705.
[5] *McAllister* v. *People*, 28 Colo. 156, 63 P. 308.

In such cases the surety can pay the debt at any time after it matures and then proceed against the principal for the money paid to his use, and at his request." [6]

Alteration of the Principal's Obligation. If the creditor assents to a material alteration of the principal's obligation, the surety or the guarantor is discharged from liability. For example, when a contract, the performance of which is secured, calls for payment in one place, and the place of payment is later changed to another without the consent of the surety, the latter is discharged.[7] The fact that the alteration was made for the benefit of the surety or the guarantor is immaterial. The alteration must, however, be a material change in the obligation, such as an increase in the amount of the debt, an insertion or erasure of important provisions, or a change involving the place of performance. The liability of the surety or the guarantor is not affected by alterations that are not material.

> N. N. and R. G. Lee were sureties on a note executed by Runnels, calling for $220, of which $20 was illegal interest. Without their knowledge or consent, the maker at the request of the holder altered the note so that it called for $200. The sureties were discharged. (Runnels v. James, 115 Miss. 607, 76 S. 566)

Alterations are deemed to be immaterial when they do not affect the position of the surety. Thus, in one case in which a one per cent reduction was made in the rate of interest, it was held that the surety was not discharged. The court stated: "In the case at bar, the new agreement was that, after a day named, the interest on the principal sum lent by the plaintiff should be at the rate of six and one half instead of seven and one half per cent. It was clearly not the intention of the parties to discharge the note and substitute a new contract in its place. The agreement presupposed that the note was to remain in force as a promise to pay the principal debt. . . . It was clear also that the change in the original

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[6] *Bean* v. *Chapman*, 62 Ala. 58.
[7] *Pelton* v. *San Jacinto Lumber Co.*, 113 Calif. 21, 45 P. 12.

contract, by reducing the rate of interest, could not be prejudicial to the sureties. It is to be borne in mind that there was no contract by the plaintiff giving time to the principal debtor, and no contract by the debtor that the amount of the note should remain on interest at the new rate for any time. The plaintiff could at any time have paid the note and have had a right to sue the principal at once. The agreement was merely a stipulation to remit a part of the sum which the plaintiff might claim under the note. It did not tie the hands of the creditor or alter unfavorably the condition of the surety." [8]

> Courts have differed as to whether there is a material alteration when there is the addition of the name of a witness to the signature of the surety. (Yes, Swank v. Kaufman, 255 Pa. 316, 99 A. 1000; no, J. R. Watkins Medical Co. v. Montgomery, 140 Ark. 487, 215 S. W. 638)

The alteration must be made with the express or implied consent of the creditor or obligee. If a stranger alters the contract, it is mere spoliation which does not affect the rights of the surety or the guarantor. So, also, if the principal, without the knowledge of the creditor, changes his obligation, it is not an alteration that will release the surety or the guarantor but is treated as a spoliation. For example, when the creditor is illiterate and does not detect a change made by the principal in a note of which he is the maker, the surety is not discharged.[9]

Extension of Time. The surety or the guarantor is discharged if the creditor or obligee without the consent of the former enters into an agreement with the principal to extend the time of performance or payment. To illustrate, when the creditor accepts a note payable at a date later than the time of performance of the original obligation, it is an extension of time that will release the surety.[10] An extension of time not only changes the contract, but also prevents the surety or the

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[8] *Cambridge Savings Bank* v. *Hyde*, 131 Mass. 77.
[9] *Bucklen* v. *Huff*, 53 Ind. 474.
[10] *Frank* v. *Williams*, 36 Fla. 136, 18 S. 351.

guarantor from making payment and proceeding against the principal. During the period of extension the principal may become insolvent, thus injuring the surety or the guarantor. That the extension of time may be beneficial to the surety or the guarantor is immaterial. The rule is not applied, however, if the creditor has no knowledge of the relation of suretyship. Thus, if a person, as surety, joins another in making a promissory note, an extension of time to the latter does not discharge the former unless the creditor has express or implied notice of his position.[11]

> The tendency today is to hold that extension of time will not discharge a paid surety, that is, a corporation receiving a premium for assuming the risk, unless actual harm is shown. (Standard Malt & Cement Co. v. National Surety Co., 134 Minn. 121, 158 N. W. 802)

The extension must be the result of a binding contract. To illustrate, a gratuitous promise on the part of the creditor of an extension, not being enforceable, does not discharge the surety.[12] The agreement must bind the creditor for some period of time. A mere delay or forbearance on the part of the creditor is not sufficient. If the agreement is for a specified time, it is immaterial as to the length of the period, whether a year, a day, or a month, or merely a reasonable time.

> "The extension to the maker of a promissory note of the title of payment thereof will have the effect of discharging the surety only when the extension is for a definite period, for a valuable consideration, and without the consent of the surety." (Turner v. Womack, 30 Ga. A. 147, 117 S. E. 104)

A surety or a guarantor is not discharged by an extension when, as in the case of a release, the creditor, at the time of extending the period, makes a reservation of his right to enforce the obligation against the former. The same rule is applied when the surety or the guarantor has been given adequate security by the principal to indemnify him against loss. In both instances the rule seems to be based on the theory

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[11] *Preston* v. *Garrard*, 120 Ga. 689, 48 S. E. 118.
[12] *Burnell* v. *Prinie*, 11 Tex. Civ. A. 399, 32 S. W. 855.

that the extension under such circumstances has not injured the surety.

Loss of Securities by the Creditor. Under the general doctrine that the creditor cannot do any act which will injure the right of the surety or the guarantor, the latter is discharged to the extent of any loss of securities held by the former. For example, when the creditor negligently loses any securities in his hands, the surety is discharged to that extent.[13] Any loss due to the willful act of the creditor is, of course, a stronger reason for discharge of the surety or the guarantor. The surety or the guarantor is also released to the extent of any securities relinquished by the creditor, but not when a surrender is made for the purpose of substituting other securities of the same kind and value. In case of either loss or relinquishment, it is immaterial that the surety or the guarantor had no knowledge of the securities or the time at which they were received. Thus, if the surety pays the obligation before learning of the loss or the relinquishment of the securities, he can recover the amount of the loss from the creditor.[14]

> The surety is also discharged when the creditor has security which he "wilfully or negligently harms." (Restatement, Security, Sec. 132-b)

The rule that the surety or the guarantor is discharged by the loss or the relinquishment of securities does not apply when the creditor is not at fault. For example, the surety cannot complain when he himself is the cause of the loss.[15] So, also, the surety or the guarantor is not released when the loss is due merely to a failure to enforce the securities.[16] The better rule, however, is that adopted by the Restatement of the Law of Security, to the effect that the surety is discharged pro tanto if the creditor "fails to take reasonable action to preserve" the value of the security "at a time when the surety does not have an opportunity to take such action."[17]

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[13] *Hendryx* v. *Evans*, 120 Iowa 310, 94 N. W. 853.
[14] *Cooper* v. *Wilcox*, 22 N. C. 90.
[15] *Schroeppel* v. *Shaw*, 5 Bart. (N. Y.), 338.
[16] *Fuller* v. *Thomlinson*, 58 Iowa 111, 12 N. W. 127.
[17] Sec. 132-c.

QUESTIONS

1. The United Motors Company sold a truck on credit to Bell. Fearing that Bell would not meet his obligation, the company during the following day requested C. K. Polk to guarantee the indebtedness of Bell. Polk promised to answer for the obligation. When Bell failed to pay as agreed, the company, after a vain effort to collect and after giving notice of the default, brought an action to recover the amount of the purchase price from Polk. Was it entitled to judgment?

2. Leech entered into a contract of surety for a debt owed by Marbury. When Marbury failed to pay the obligation, the creditor brought an action against Leech who pleaded infancy as a defense. Was the creditor entitled to recover from Leech?

3. Carr was surety for a debt that was assigned by the creditor to Miller in return for the amount of the debt in cash. When the principal did not pay the debt, Miller brought an action against Carr, who contended that he had been discharged from liability. Do you agree?

4. A creditor, without the consent of the surety, agrees not to bring an action against the principal debtor. Later he sues the surety for the amount of the debt. Is he entitled to judgment?

5. Garrison was surety for a debt owed by Gallo to the Southern Grocery Company. The company, without the consent of Garrison, executed a release whereby it discharged Gallo from liability for the debt but reserved its rights against Garrison. Thereafter the company brought an action to recover the amount of the debt from Garrison. Was it entitled to judgment?

6. Zimmerer is surety for Fremont who owes one thousand dollars to Grimes. After the debt is due and payable, Fremont is discharged in bankruptcy. Grimes brings an action to recover the amount of the debt from Zimmerer. Is he entitled to judgment?

7. A. H. Mullen was surety for the amount of a note executed and delivered by Pate to Ralph Redd. Smithers, while visiting Redd, changed the amount of the note from $600 to $1,600. When Pate failed to pay the note, Redd brought an action against Mullen. Mullen contended that he was discharged from liability. Was his contention sound?

8. The guarantor of a note was compelled to pay the creditor. Thereafter the guarantor brought an action independent of the note to recover from the principal debtor. Was he entitled to do so?

9. Walsh owed $200 to Cramer, to whom he gave a bond valued at $100 as security. Cramer negligently lost the security. The guarantor of the debt thereafter contended that he was discharged from all liability for the debt. Was this contention sound?

10. A creditor returns to the principal debtor ten shares of stock valued at one thousand dollars which were transferred to him by the

latter as security for a debt of five hundred dollars. Later the creditor sues the surety. Is he entitled to judgment?

11. Chalmers executed and delivered a note to the Farmers' National Bank. He also delivered to the bank certain bank stock as security for the obligation. Thereafter the bank returned the stock to Chalmers and received in return stock of the same quality and value as security. When the note was not paid, the bank sought to collect from the surety, Flagstaff. Was it entitled to do so?

12. Leon Balph was surety for an obligation owed by Meahan to J. L. McKean. The bonds that Meahan had delivered to McKean as security were stolen one night from a large safe in which they had been placed. When Meahan failed to pay the debt, McKean brought an action to recover from Balph. Was McKean entitled to judgment?

CASES FOR REVIEW

1. J. H. McKinnon, as surety, joined Waldron in the execution of a promissory note for an aggregate sum of money owed to several creditors of Waldron. A mortgage on certain personal property was given to McKinnon by Waldron to save McKinnon harmless as surety. Thereafter N. H. Mecher, as trustee or agent of the creditors, brought a suit in equity to obtain a foreclosure of the chattel mortgage and to have the proceeds applied to the payment of the note that was due and unpaid. Was he entitled to judgment? (Mecher v. Waldron, 62 Nebr. 689, 87 N. W. 539)

2. M. O. Cockrell and H. K. Green were sureties for an obligation owed by J. H. Oldham to the Mt. Sterling Improvement Company. The creditor company executed a levy on the property of Oldham sufficient to satisfy the debt. By reason of negligence on the part of the creditor company or its agent, the lien was lost. Thereafter the Mt. Sterling Improvement Company brought an action to recover from Cockrell and Green. Was it entitled to judgment? (Mt. Sterling Imp. Co. v. Cockrell, 24 Ky. L. 1151, 70 S. W. 842)

3. The Dakota Loan & Trust Company entered into a contract whereby it guaranteed the collection of a promissory note for the sum of $700 executed by Sidney Harrington. Bertha Stackpole, the holder of the instrument, without making an attempt to collect on the note from Harrington and without any excuse for not so doing, brought an action against the Dakota Loan & Trust Company to recover on the contract of guaranty. Was she entitled to judgment? (Stackpole v. Dakota Loan & Trust Co., 10 S. D. 389, 73 N. W. 258)

4. Joseph Krekey entered into an agreement to guarantee the performance of B. A. Tinnes under a contract between Tinnes and Carroll S. Page, whereby Tinnes was to buy certain skins or to deliver them to Rose, McAlpin & Company. The contract, however, as made by Tinnes and Page, required Tinnes to buy or to deliver the skins to Meyers & Gordon. When Tinnes failed to perform as promised, Page brought an action against Krekey to recover on the contract of guaranty. Was he entitled to judgment? (Page v. Krekey, 137 N. Y. 307, 33 N. E. 311)

5. Louis A. Hippach executed an agreement whereby he became the guarantor of a promissory note executed by Charles F. Hippach. Thereafter the payee accepted the instrument. When the note was due and unpaid, Sanford Makeever brought an action against Louis A. Hippach to recover on the contract of guaranty. As a defense, Hippach pleaded lack of consideration. Was Makeever entitled to judgment? (Hippach v. Makeever, 166 Ill. 136, 46 N. E. 790)

6. Olaf Benson and others were sureties for a debt owed by William H. Gugisberg for the purchase price of cement pipe supplied by the Saffert-Gugisberg Cement Construction Company, a Minnesota corporation. The creditor company had a lien on certain stock, issued to Gugisberg, as security for the payment of the indebtedness. When the obligation was due, the sureties were compelled to pay the debt. Thereafter they contended that they were entitled to the benefit of the lien on the stock of the debtor that was held by the creditor as security. Do you agree with this contention? (Benson v. Saffert-Gugisberg Cement Const. Co., 161 Minn. 269, 201 N. W. 424)

7. D. S. Buchanan was the guarantor of the purchase price of certain goods, owed by J. T. Ingman to Manning, Cushman & Company. The creditors, without the consent of Buchanan, made a binding agreement with Ingman, whereby the time of payment was extended. When the debt was due and unpaid, Manning, Cushman & Company presented a claim based on the contract of guaranty against the estate of Buchanan. The executor of the estate contended that there was no liability under the contract of guaranty. Was this contention sound? (Manning v. Alger, 85 Iowa 617, 52 N. W. 542)

8. In order to induce B. A. Eckhart to accept a promissory note, G. B. Gundert for a valuable consideration promised in writing that he would "stand back of and become responsible for" the instrument. Thereafter Eckhart brought an action to recover the amount of the note from Johannes Heier and Gundert. It was contended by Gundert that his undertaking was neither that of a surety nor that of a guarantor. Do you agree with this contention? (Eckhart v. Heier, 37 S. D. 382, 158 N. W. 403)

9. George M. Hard, Edward Thompson, and Sampson Q. Mingle were coguarantors of a promissory note payable to the Chatham National Bank of New York that was executed by the Realty Corporation

of North America. The maker of the instrument became insolvent, and Hard paid the amount of the note to the bank. Thereafter Hard brought an action to recover one third of the amount he had paid to the bank from the estate of Mingle. Was Hard entitled to judgment? (Hard v. Mingle, 206 N. Y. 179, 99 N. E. 542)

10. Mrs. R. R. Read and others wrote to the *Birmingham News* Company, offering to guarantee payment of the price of such copies of the *Birmingham News* as the company might furnish on credit to A. F. Joseph, of Anniston, Alabama. Copies of the paper were supplied by the company to Joseph, but notice of such fact was not given to the guarantors. Thereafter the publishing company brought an action against Mrs. Read and others to recover on a contract of guaranty. Was it entitled to judgment? (Birmingham News Co. v. Read, 200 Ala. 655, 77 S. 29)

11. D. G. Eshleman and Robert M. Bolenius were sureties for an obligation owed by Daniel M. Harman. Eshleman received certain money that was to be applied toward fulfilling the obligation. The money was lost by reason of an unauthorized loan made by Eshleman to A. S. Henderson, who became insolvent. Eshleman paid the amount of the loss to the creditor of Harman and brought an action to recover one half of such amount from Bolenius. Was he entitled to judgment? (Eshleman v. Bolenius, 144 Pa. 269, 22 A. 758)

12. On the back of a promissory note that was payable to David M. Cowles, Peck wrote the following undertaking: "I guarantee the within note good until paid." In an action brought by the administrator of the estate of Cowles against Peck, it was contended that the foregoing undertaking was an absolute guaranty. Do you agree with this contention? (Cowles v. Peck, 55 Conn. 251, 10 A. 569)

13. O. P. Schwitzerlet and W. Cleveland Seigler were sureties for the payment of a note payable to the order of the Citizens' & Southern Bank, which was executed by the Schwitzerlet-Seigler Company. The bank released the company from liability on the instrument but reserved its rights against the sureties. Thereafter in an action brought by the bank, the sureties contended that they had been discharged from liability. Do you agree? (Schwitzerlet-Seigler Co. v. Citizens' & Southern Bank, 155 Ga. 740, 118 S. E. 365)

14. Mrs. Rosa K. Josephian entered into a contract as surety for an obligation owed by her son-in-law, Alex Lion, to Leila A. Yocum. When the obligation was due, Lion failed to pay it. Mrs. Josephian brought a suit against Lion to compel him to save her harmless by paying the amount of the indebtedness. Was she entitled to judgment? (Josephian v. Lion, 66 Calif. A. 650, 227 P. 204)

15. Mrs. M. A. Cox entered into an oral agreement with J. B. Wray, manager of the business owned by Mrs. M. T. Wray. She promised that, if the store furnished on credit certain merchandise to two Ne-

groes, Henry Whitten and Anthony Bobo, she would see the bill paid. Thereafter Mrs. Wray brought an action against Mrs. Cox to recover the amount of the debt owed by the two men. Was Mrs. Wray entitled to judgment? (Wray v. Cox, 86 Miss. 638, 38 S. 344)

16. S. J. Hess and L. G. Harley entered into a contract with the J. R. Watkins Medical Society whereby they became sureties for the payment of the sum of $833.88, owed by H. D. Flora, of Kokomo, Indiana, to the medical society. When the obligation was not paid by Flora, notice of the default was not given to the sureties. Thereafter the medical society brought an action against Hess and Harley to recover on the contract of suretyship. Was it entitled to judgment? (Hess v. J. R. Watkins Medical Co., 70 Ind. 416, 123 N. E. 440)

17. C. S. Jones and another were guarantors of an obligation owed by the Osage City Bank to Julius Kuhn. The guarantors were compelled to pay the amount of the indebtedness. Thereafter they brought an action against the Osage City Bank to recover the amount that they had been required to pay. Were they entitled to judgment? (Osage City Bank v. Jones, 51 Kans. 379, 32 P. 1096)

18. Delos A. Chappell and James M. John were sureties for an obligation owed by W. A. Burnett to the First National Bank of Pueblo, Colorado. The bank transferred the note of Burnett to James McKeough, who paid the amount thereof to the bank. Thereafter McKeough brought an action to recover from Chappell, as surety for the obligation. Chappell contended that he had been discharged from liability by payment. Was his contention sound? (Chappell v. McKeough, 21 Colo. 275, 40 P. 769)

19. W. H. Baker was about to open a cafe in St. Paul, Minnesota. To induce Patrick D. and Cornelius L. Twohy, who were engaged in the grocery business, to extend credit to Baker, J. R. McMurran sent the following letter: "Messrs. Twohy Brothers, Broadway, City—Gentlemen: If you desire to give Mr. William H. Baker a credit of two hundred and fifty dollars ($250) with your house for provisions for the restaurant in the Colonade, corner 10th and St. Peters Streets, I will be responsible for such amount." In an action brought by the Twohy brothers against McMurran, it was contended that the foregoing undertaking was a limited guaranty. Do you agree? (Twohy v. McMurran, 57 Minn. 242, 59 N. W. 301)

20. Certain persons became sureties for an obligation owed by Samuel Ellis to George W. Whereatt. Ellis thereafter became insolvent and was discharged from his debts in due form of law under a statute. When the obligation was not paid at maturity, Whereatt brought an action against Ellis and the sureties to recover the amount of the debt. The sureties contended that they had been discharged from liability for the obligation. Was this contention sound? (Whereatt v. Ellis, 103 Wis. 348, 79 N. W. 416)

21. Clyde Walton became an absolute guarantor of bonds issued by the Walton Lumber Company. During subsequent litigation, it was contended that, because this was an absolute guaranty, the holder was not required to pursue the principal before resorting to Walton. Do you agree? (Robey v. Walton Lumber Co., 17 Wash. [2d] 242, 135 P. [2d] 95)

22. C. Rowen was under an obligation to pay for the remodeling of a beauty shop, for which W. Merrill was surety. Although Merrill had not been troubled by the creditor, he brought a proceeding after maturity of the debt to compel Rowen to pay the obligation. Was he entitled to a decree? (McKey-Fansher Co. v. Rowen, 232 Iowa 660, 5 N. W. [2d] 911)

23. Wilson Bros. Lumber Company sold certain lumber to W. H. Furqueron. About a week later Nellie Furqueron signed a guaranty of payment of the price. When sued, it was contended that the guaranty was not binding without a new consideration. Do you agree with this contention? (Wilson Bros. Lumber Co. v. Furqueron, 204 Ark. 1064, 166 S. W. [2d] 1026)

24. George W. Stratton was guarantor upon a lease. When the lessee could not pay the rent one month when due, the lessor, as a matter of leniency to the lessee, extended the time for payment until sixteen days later. The guarantor contended that he was discharged by the action of the lessor. Was this contention sound? (Davenport v. Stratton, 24 Calif. [2d] 232, 149 P. [2d] 4, prior opinion, 141 P. [2d] 713)

CHAPTER VI

INSURER AND INSURED

Part I—General Considerations

Introduction. The businessman is, in his activities, confronted with many perils of one kind or another. Misfortune may come at any time to the most prudent man engaged in business because of malicious, willful acts of others, such as thieves or embezzlers; of acts of God, such as floods or wind storms; or of changes in the wants of society, such as the giving way of horse carriages to automobiles. The businessman must avoid, meet, or shift these risks. It is true that the perils are uncertain and may not seriously threaten any particular business. On the other hand, any one of them may cause disaster to an individual in business, unless he can avoid the materialization of the risk, carry the risk himself, or shift the risk to others.

The most common risk-bearing device is *insurance*. By means of this device, the businessman buys protection from some of these perils. He pays a small sum to the one assuming the risk, and in return he receives a promise of indemnity in case of a loss. In most instances there is no materialization of the risk; consequently the one assuming the risk is able to pay the loss which does occur. In this connection a distinct service to society is rendered, in that any loss is shared lightly by many and does not fall heavily upon any one person or group. The business of insurance, growing by leaps and bounds, has become one of the most important institutions in economic life. Any person who professes to be a businessman, unless he can avoid or carry the risks which are incident to his particular business, must shift these risks to others. For this reason he should acquire a knowledge of some of the principles of law governing such transactions.

The law of insurance is of remote origin. There is scarcely any record of its beginnings. It is clear, however, that contracts of insurance were used frequently by the merchants trading in Mediterranean ports during the Middle Ages. The

practice of using such contracts later spread throughout the European countries engaged in maritime trade. The rules governing insurance became part of the law merchant because uniformity in the law was made necessary by the fact that traders using contracts of insurance were mainly engaged in international commerce. The rules and customs of the merchants in respect to insurance were finally absorbed by the common law about the beginning of the nineteenth century. During this development, however, the field of insurance did not remain limited to the hazards of the sea, but it broadened so as to include many other uncertain perils which beset merchants and others. Modern insurance has even a greater field, being adapted to cover practically all forms of risks which arise out of our economic and social life.

Definition. A contract, the provisions of which bind one party to indemnify another for loss or damage suffered on a specified contingency, is described as a contract of *insurance.* The individual or association assuming the risk of another for compensation is known as the *insurer.* When two or more insurers make a contract of insurance on identical subject matter, they are termed *coinsurers.* The person whose death, injury, or loss of property gives rise to liability on the part of the insurer is described as the *insured.* This term is sometimes, but not ordinarily, used to indicate the one to whom the indemnity is made. The term *assured* is also used interchangeably with the term *insured.*

> "An insurance contract is one whereby for a stipulated consideration one party undertakes to compensate the other for loss on a specified subject by specified perils. Black's Law Dictionary (2d Ed.) p. 641. This is sometimes spoken of as a contract of indemnity." (Chicago Bonding & Ins. Co. v. Oliner, 139 Md. 408, 115 A. 592)

The form of the indemnity is immaterial. If one person assumes the risk of another, a contract of insurance, regardless of the form of indemnity, comes into existence. It is therefore evident that the essential element of insurance is the assumption of the risk of another. In the absence of this element, a contract is not one of insurance. For example,

when a group of persons agree to pay regular sums into a common fund, and agree to pay each member a certain amount provided he does not leave the city, the contract is not one of insurance, for there is no risk involved.[1] On the other hand, any contract under which one person agrees to pay the amount of damage suffered by another, as for the loss of a tractor, is a contract of insurance.

Classification. Insurance may be divided into as many different classes as there are kinds of risks, but it may be classified into three more or less distinct groups, namely: (1) property, (2) personal, and (3) business. The last group includes many recently developed forms of insurance which, although they might be placed in one of the other classes, seem to involve essentially different kinds of risks.

Property Insurance. Insurance of this class is that in which the risk involves a loss through an injury to property by certain specified causes. Several of the common contingencies against which insurance on property is effected are: first, injuries or losses due to natural forces, such as fire, tornadoes, cyclones, lightning, hail, and floods; second, injuries or losses due to human activity, such as theft and riots.

Personal Insurance. In this class of insurance either the subject matter or the risk is personal. Some of the common forms of insurance of this nature are those in which, first, the subject matter is the person, as in the case of life, health, and accident insurance; or, second, the risk is in a person's conduct toward others, as in the case of insurance against injuries caused in driving, or in breach of fidelity or trust.

Business Insurance. This class embraces the forms of insurance which protect the insured in his business transactions. Forms illustrating this type are those which protect the insured in situations where, first, losses may result from expenses incurred or goods delivered under certain expectations, when there is a risk involving rain, cold weather, or credit; or, second, losses may result from injuries to workmen.

The Insurer. Any person or association of individuals, unless forbidden by law, may engage in the business of in-

[1] *State* v. *Towle*, 80 Me. 287, 14 A. 195.

surance. The state under its police power may, however, restrict the right to conduct such business and, for the protection of the public, may allow only associations of a certain type to engage in it. Hence legislatures usually not only limit the business to corporations, but also supervise and regulate the transactions of the business.

> "It is a well-settled fact that the business of insurance is of such peculiar character, affects so many people, and is so intimately connected with the common good that the State creating insurance corporations and giving them authority to engage in that business may, without transcending the limit of legislative power, regulate their affairs so far at least as to prevent them from committing wrongs, or injustice in the exercise of their corporate functions." (Merchants Liability Co. v. Smart, 267 U. S. 126, 69 L. Ed. 538)

In the absence of statutes, the insurer is ordinarily a company of some kind, preferably a corporation. This form of organization not only gives financial stability but also promises continuity which is of prime importance. A company organized to conduct an insurance business is usually classified as a stock, mutual, or mixed company.

Stock Company. This type of company is one in which the capital, divided into shares, is contributed by the owners thereof who divide the profits of the business. The rights and duties of the stockholders are usually the same as in the case of other corporations, although in some instances statutes impose a liability in excess of the amount of their subscription.

> "A stock life insurance company is one in which the initial capital investment is made by the subscribers to the stock, and the business is thereafter conducted by a board of directors elected by its stockholders, and, subject to state statutes, the distribution of earnings or profits as between stockholders and policyholders is determined by the board of directors." (Atlantic Life Ins. Co. v. Moncure, 35 F. [2d] 360)

Mutual Company. This type of company is one usually having no capital stock, in which the members agree to indemnify each other for losses. Payments are made out of a

fund created under a system of assessment, or of small regular payments plus assessments. The members of the company consequently have the relation of both insurer and insured. Each is entitled to a pro rata share in the profits of the business. In some states there is special legislation regulating companies which operate under the assessment plan.

> "A mutual insurance association is one in which the members are both the insurers and the insured; and the premiums paid by them constitute the fund which is liable for the losses and expenses, and they share in the profits in proportion to their interest and control and regulate the affairs of the association." (Rosebraugh v. Tigard, 120 Oreg. 411, 252 P. 75)

Mixed Company. This type of company is one possessing certain features of both the mutual and the stock companies. It resembles the latter in that ordinarily there is a small number of stockholders who contribute the capital and are entitled to dividends. On the other hand, it is like the mutual company in that each insured becomes a member of the company and enjoys in some manner the benefits of its prosperity.

The Insured. Any person who at common law is capable of entering into a binding agreement may make a contract of insurance as the insured. The ordinary principles of contract also govern an insurance contract. Thus an enemy alien, a married woman at common law, or an adjudged lunatic cannot contract as an insured.[2] When an infant elects to avoid an insurance contract, he may in some states recover the amount of premiums paid; whereas in other jurisdictions he is permitted to recover only the amount paid in excess of the protection received. The latter rule is followed in England, and it seems to be the better view.

> In New York a statute declares that a person insuring his own life for benefit of himself or of his family shall not by reason of minority "be deemed incompetent to contract for such insurance." (Equitable Trust Co. v. Moss, 149 App. Div. 615, 134 N. Y. S. 533)

It is sometimes said that another limitation as to the party who may become an insured is that he must have an insurable

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[2] *Ante*, Chapter I, Part VI.

interest. In other words, there must be an interest to protect. This is not, strictly speaking, a limitation on the party who may become an insured, but it more properly involves the question of whether the contract is one of insurance. When there is no interest to protect, the insurer can assume no risk; and when there is no assumption of risk, the contract is not one of insurance.

Insurable Interest. In an insurance contract there must be an assumption of risk; the insured must have an interest to protect against loss. The interest required of an insured is called an *insurable interest.* It is frequently difficult to determine whether a person has such an interest, the nature of which can only be defined in rather general terms.

In Property Insurance. One has an insurable interest in property when he has any right or interest therein, so that a direct pecuniary loss will result to him in the event such property is destroyed or injured. For example, when an individual ships his goods to a commission merchant for sale, the merchant has an insurable interest in such goods.[3] "An interest, to be insurable, does not depend necessarily upon the ownership of the property. It may be a special or limited interest, disconnected from any title, lien, or possession. If the holder of an interest in property will suffer loss by its destruction, he may indemnify himself therefrom by a contract of insurance." [4] It is essential that the interest exist at the time of the loss, and some states require its existence at the time of making the contract.

> "An interest in property must exist when the insurance takes effect, and when the loss occurs, but need not exist in the meantime." (California Codes and Laws, Deering's 1935 Supp., Insurance Code, Sec. 286)

In Life Insurance. Every person has an insurable interest in his own life. Whether one person has an insurable interest in the life of another, depends on whether there is such a rela-

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[3] *Citizens' Ins. Co.* v. *Herpolsheimer,* 77 Nebr. 232, 109 N. W. 160.
[4] *German Ins. Co.* v. *Hyman,* 34 Nebr. 704, 52 N. W. 401.

tion that the death of the one on whose life the insurance is taken, would deprive the one taking out the insurance of some benefit. In some cases the interest is obvious. For example, a creditor has an insurable interest in the life of a debtor.[5] Courts, however, do not limit the interest to a relation in which one is under a duty or liability to another. It seems sufficient if the parties are in such a relation that one or both may reasonably expect some benefit from the continued existence of the other. To illustrate, when a woman effected insurance on the life of her niece, the court declared that "the relation of the plaintiff and her niece had been of such character that each had reason to rely upon the other in case of need. Should the younger die first, the help and care which might have been expected from her, in the declining years of the aunt, could only be supplied by insurance upon her life." [6] It should be noted that there existed a relation which gave reasonable expectation of benefit. Although there are dicta that close kinship is sufficient, there is also, in practically every case involving close kinship, a reasonable expectation of some benefit to be derived by the person taking out the insurance if the insured survives.

> "One has no insurable interest in his brother-in-law; and in this case, if the contracts of insurance were issued to the plaintiff as the brother-in-law of Yerby, pure and simple, then the said contracts of insurance are illegal." (Chandler v. Mutual Life & Industrial Ass'n, 131 Ga. 82, 61 S. 1036)

In life insurance, contrary to the rule in property insurance, a person need not have an insurable interest at the time the loss occurs provided he had an insurable interest at the time the policy was taken out.

Validity. A contract of insurance may be voidable for reasons which would render any other contract defective. Under some circumstances, however, courts may hold that the agreement is void. Some of the grounds which render contracts of insurance void will be considered briefly.

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[5] *Alexander* v. *Sanders*, 93 Ala. 345, 9 S. 521.
[6] *Cronin* v. *Vermont Life Ins. Co.*, 20 R. I. 570, 40 A. 497.

Violation of Statute. Legislatures may expressly declare that certain parties cannot make contracts of insurance or that certain provisions shall not be contained in the policy. In these cases the contract or the provisions will be unenforceable. On the other hand, contracts of insurance made in violation of statutory regulations may be valid. For example, a foreign insurance company failed to comply with a statute requiring the taking out of a license and the filing of reports with the clerk of the county court, but the court held that the contract of insurance was valid.[7]

> A statute in Pennsylvania "makes it unlawful for any person, partnership, or association to issue a policy of fire insurance without authority expressly conferred by a charter of incorporation, and declares that 'every such policy, contract, and guaranty hereafter made, executed, or issued shall be void." (Weed v. Cuming, 198 Pa. 442, 48 A. 409)

Ultra Vires Contracts. It will be noted later that ultra vires contracts of corporations may in some instances be binding.[8] If, however, a company issues a policy without authority to make the contract of insurance, the contract is void in the Federal courts and in some states. In most states, however, the corporation is denied the defense of ultra vires.

> "After a corporation has received the fruits which grow out of the performance of an act ultra vires, and the mischief has all been accomplished, it comes with an ill grace then to assert its want of power to do the act or make the contract, in order to escape the performance of an obligation it has assumed." (Wright v. Hughes, 119 Ind. 324, 21 N. E. 907)

Contrary to the Public Good. Insurance contracts which indemnify the insured for a loss due to a criminal act or an illegal adventure are void. To allow the assumption of risk in such cases would encourage conduct contrary to public interest. In other cases the provisions of the contract may be opposed to the public good. To illustrate, a provision of a contract making the policy incontestable from date may be considered as socially undesirable; hence it is void.[9]

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[7] *Columbus Ins. Co.* v. *Walsh*, 18 Mo. 229.
[8] *Post*, p. 684.
[9] *New York Life Ins. Co.* v. *Hardison*, 199 Mass. 190, 85 N. E. 410.

A promise of an insurer to pay upon the death of a person though death is caused by suicide when sane, is illegal. (Restatement, Contracts, Sec. 572, Illust. 2)

Lack of Insurable Interest. It is generally stated that an insurance contract without an insurable interest is void. This statement is not strictly accurate. It is inconsistent to speak of lack of insurable interest in a contract that is granted to be one of insurance. If there is no insurable interest, there is no insurance. A contract purporting to be that of insurance, "obtained by a party who has no interest in the subject matter of insurance, is a mere wager policy." [10] The enforcement of such contracts depends upon the common-law rule or statutory rules applicable to wagering contracts. These contracts are, as a matter of fact, quite generally considered invalid on the grounds of public policy. The court, in the case just cited, declared: "Such policies, if valid, not only afford facilities for a demoralizing system of gambling, but furnish strong temptations to the party interested to bring about, if possible, the event insured against. In respect to the insurance against fire, the obvious temptation presented by a wagering policy to the commission of the crime of arson has generally led the courts to hold such policies void, even at common law." The court further points out that such contracts, "without interest upon lives, are more pernicious and dangerous than any other class of wagering policies, because temptations to tamper with life are more mischievous than incitements to mere pecuniary frauds."

QUESTIONS

1. Ten young men deposited each week a stipulated sum into a common fund under an agreement that at the end of ten years the amount would be divided among the number who were unmarried at the time. In an action brought by the state against the members of this group, it was contended that the foregoing agreement constituted an insurance contract. Do you agree?

2. Krogman is the promoter of a boxing match to be held on a given Fourth of July. He deposited ten thousand dollars in a bank as

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[10] *Ruse* v. *The Mutual Benefit Life Ins. Co.*, 23 N. Y. 516.

a guaranty to the fighters, and he constructed a temporary stadium. He then took out a policy of insurance against rain on that day. Is this insurance classified as personal, business, or property insurance?

3. A statute of the state of New York prescribed that the business of insurance could be conducted only by corporations created for such purpose. In an action brought by the state against Loew, it was contended that the state had no right to deny the right to carry on the business of insurance to individuals, partnerships, or unincorporated associations. Was this contention sound?

4. In an action brought by Hogan against the Union Beneficial Insurance Company, the court declared: "The members of a mutual insurance company have the relation of both insurer and insured." What was meant by this statement?

5. Meyering, an infant, insures his house against loss by fire. Some months later the building is destroyed. The company refuses to pay the amount of the loss on the ground that the contract of insurance was not binding because of Meyering's infancy. Meyering brings an action to recover on the policy. Is he entitled to judgment?

6. Schoen, who lives in Florida, owns a farm in Indiana. Elder ejects the tenant and takes possession of the premises, claiming the farm as his own. He later insures the house and barns against loss caused by lightning. One of the barns is destroyed by lightning during a severe storm. The insurance company refuses to pay the policy loss on the ground that Elder had no insurable interest. Is the refusal to pay justified?

7. Which of the following persons, if any, have an insurable interest in Lippman's life: (a) his uncle, (b) his wife, (c) his niece, (d) his minor son?

8. Langford owes a debt to Burr. The latter takes out a policy of insurance on Langford's life and a policy of insurance against fire on Langford's home. Later the house is destroyed by fire. On the following day Langford dies. The insurance company contends that neither of the policies is a contract of insurance because Burr had no insurable interest. Do you agree?

9. "Lack of insurable interest has no bearing on the validity of a contract that is granted to be one of insurance." What is meant by this statement?

10. Martin has secretly arranged to supply coal to a war vessel of a country engaged in war against his own country. He intends to meet another ship at a specified place on the high seas and to be conducted to a place where the coal is to be transferred to the receiving ship. Before leaving his home port, Martin takes out insurance against loss of cargo. The first day at sea the ship carrying Martin's coal runs into a severe storm and goes down. The company refuses to pay Martin's claim for indemnity. Is the company justified in its refusal?

Part II—Effecting Insurance

Form of Contract. A contract of insurance need not be in writing, unless that is required by statute. Although an oral contract of insurance may be valid, it must be clear that under such circumstances present insurance was intended. To illustrate, if the parties orally negotiate for insurance, setting forth the terms and conditions, but really contemplate consummation thereof by a written contract, no insurance is effected.[1]

> There is no contract when a written memorial is contemplated, "if an intention is manifested in any way that legal obligations between the parties shall be deferred until the writing is made." (Restatement, Contracts, Sec. 26, Comm. a)

In some jurisdictions a contract of insurance is expressly required to be in writing. In others there are statutory requirements which are construed to have that effect. For instance, one court declared, "Oral contracts (of insurance) are impossible under our statute."[2] A contract of insurance, however, does not come within the provisions of the Statute of Frauds. In the absence of statutory requirement, contracts of insurance are ordinarily made in writing. The written evidence of the terms and conditions of a contract of insurance is known as a *policy* or *policy of insurance.*

> "Contracts of insurance, to be binding, must be 'evidenced by a policy of insurance in writing or print, or both, * * *.' Civil Code 1910, Sec. 2404." (John Hancock Mut. Life Ins. Co. v. Ludwick, 45 Ga. A. 631, 165 S. E. 918)

Legislatures frequently prescribe a standard form for insurance policies, in some instances requiring its use and in others leaving the matter optional with the company. The size and style of type used in printing policies are sometimes regulated by statute. Thus a statute may forbid the printing of any portion of the policy in type smaller than a size specified.[3] Regulations of this kind are intended for the protection of the insured. In this connection one court stated: "The legis-

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[1] *Meyer* v. *Liverpool, etc., Ins. Co.,* 121 Mass. 338.
[2] *Salquist* v. *Oregon Fire Relief Assoc.,* 100 Oreg. 420, 197 P. 312.
[3] *Letzler* v. *Pacific Mutual Life Ins. Co.,* 119 Ky. 924, 85 S. W. 177.

lature undoubtedly intended that any exception contained in the policy should be so conspicuously printed that it would attract the attention of the insured, and so plainly expressed that it would leave no doubt as to its meaning and application. In other words, the exception should refer, in the terms contained in the policy, to the subject matter to which it intended to apply, so that the insured would at least be put upon inquiry, in order to preserve the integrity of his indemnity and prevent any diminution thereof, which is to him the chief object of his contract." [4]

Premiums. The amount of money which the insured pays or promises to pay as consideration for the company's promise to indemnify upon the happening of a contingency, is known as a *premium.*[5] When the amount of payment by the insured is not fixed, but is payable only when a certain sum is found to be necessary to meet losses, it is described as an *assessment.* The amount of premiums and the time, place, and manner of payment are ordinarily clearly stated in the contract. These matters may, however, be regulated by statute. For example, legislation in many states prohibits both discriminating between persons in the same class, and making rebates to particular persons.[6] Premiums are payable on the specified date without notice, in the absence of an agreement or a statutory provision to the contrary. At one time policies frequently contained a provision that the insurance might be forfeited if the insured failed to pay a premium when due. Upon their own initiative, or by statutory requirement, insurance companies under such circumstances frequently give an extension of protection for a limited period, or they consider the insured as having a paid-up policy for a smaller amount.

> "Forfeitures are frowned upon by the courts, and insurance companies will not be permitted to declare forfeitures for nonpayment of premiums as long as they have funds available in their hands with which the premiums might be paid." (Continental Life Ins. Co. v. Gray, 188 Ark. 65, 64 S. W. [2d] 554)

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[4] *Hopkins* v. *Conn. Gen. Life Ins. Co.*, 225 N. Y. 76, 121 N. E. 465.

[5] In life insurance, payment of the first premium or a promise to pay the first premium constitutes the consideration.

[6] *People* v. *Amer. Life Ins. Co.*, 267 Ill. 504, 108 N. E. 679.

Premiums are sometimes paid by note. In the absence of stipulation in the policy or the premium note, nonpayment of the note does not cause a forfeiture of the policy. For example, when the insured fails to pay a premium note, the insurance remains in force, the company's only recourse being to sue on the note.[7] In the event that there is a provision for forfeiture, the latter becomes effective immediately upon failure to pay.

> " 'Under the rule of the Federal courts, failure to pay at maturity a note given for a past-due premium on a life insurance policy, containing a provision for forfeiture in such case, works an absolute forfeiture of the policy.' " (Lincoln Nat. Life Ins. Co. v. Hammer, 41 F. [2d] 12)

The insured, having paid premiums, cannot as a general rule recover them after the risk has attached. There are a few instances, however, in which the insured may recover, as when the payments were made under a mistake of fact or when they were induced by fraud on the part of an agent of the company. To illustrate, when payments were made under the belief that the insured still lived, the payments made subsequently to his death may be recovered.[8] When the company has wrongfully terminated the policy, some courts allow a recovery of the premiums. Other courts, however, restrict the insured to a right of action for breach of contract or specific performance. If the risk has not attached, the insured may as a general rule recover the premiums. There are some instances, however, as when he is at fault, in which he cannot recover the premiums. Thus, if the insured obtains a policy by fraud, he is not entitled to recover the premiums paid.[9]

Concealment. A contract of insurance, like any other contract, may be avoided on the grounds of fraud. There is one kind of fraud, however, which is peculiar to insurance. It consists of an intentional withholding of material facts from the insurer. The nature of insurance requires that the parties

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[7] *Griffith* v. *New York Life Insurance Co.*, 101 Calif. 627, 36 P. 113.
[8] *Equitable Life Assur. Soc.* v. *Brame*, 112 Miss. 859, 73 S. 812.
[9] *Nat'l Mut. Fire Ins. Co.* v. *Duncan*, 44 Colo. 472, 98 P. 634.

act in good faith. As the decision of the insurer to assume a risk is based upon information within his knowledge, the insured must in good faith disclose all material facts known to him. Willful failure to disclose these facts is known as *concealment.*

> "Beyond doubt an applicant for insurance should exercise toward the company the same good faith which may be rightly demanded of it. The relationship demands fair dealing by both parties." (Mutual Life Ins. Co. v. Hilton-Green, 241 U. S. 613, 60 L. Ed. 1202)

The English rule in respect to concealment does not require fraudulent intent to conceal. Except in case of marine insurance, our courts define concealment only in terms of fraud. "Concealment is the designed and intentional withholding of any fact, material to the risk, which the assured in honesty and good faith ought to communicate." [10] Fraudulent intent may, however, be implied by the circumstances. For example, if a man when taking out insurance withholds the fact that he is about to undertake an extremely hazardous enterprise, fraudulent intent is likely to be inferred.[11] It is, of course, a question of fact for the jury to determine. The rule requiring disclosure of all known material facts has been somewhat relaxed in case of fire insurance, because of the possibility and practice of the company to make an inspection of the property.

> In case of fire insurance, unless silence amounts to bad faith, one need not volunteer information in the absence of questions, for "it must be presumed that the insurer has in person or by agent in such a case, obtained all the information desired as to the premises insured, or ventures to take the risk without it, and that the insured, being asked nothing, has a right to presume that nothing on the risk is desired from him." (Clark v. Manufacturers' Ins. Co., 8 How. [U. S.] 235, 12 L. Ed. 1061)

Concealment has no effect on insurance contracts unless it is concealment of material facts. A material fact, however,

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[10] *Sun Ins. Office, Limited, of London* v. *Mallick,* 160 Md. 71, 153 A. 35.

[11] *Penn. Mut. Life Ins. Co.* v. *Mechanics' Sav. B. & T. Co.,* 72 F. 413.

is not one which necessarily increases the risk or contributes to the loss. The fact is presumed to be material when it, if known to the insurer, would influence the latter either in rejecting the risk or in determining the provisions embodied in the contract. For example, if a person hears a rumor that a warehouse in which he has goods stored is on fire, and he effects insurance on the goods, concealing the information which he has received, such information would be material, and, although erroneous, its nondisclosure would amount to concealment.[12]

> "The test of materiality of a fact was stated by Story, J., to depend upon whether it would have influenced the underwriter 'either not to underwrite at all, or not to underwrite, except at a higher premium.'" (Hare & Chase v. National Surety Co., 49 F. [2d] 447)

When the insurer makes a specific inquiry about a fact, the fact is legally material, regardless of its logical materiality. In such cases, however, if the insured refuses to answer or answers in part only, except when the answer appears complete, there is no concealment. To illustrate, "if one applying for insurance upon a building against fire is asked whether the property is incumbered, and for what amount, and in his answer discloses one mortgage, when in fact there are two, the policy issued thereupon is avoided. But if, to the same question, he merely answers that the property is incumbered, without stating the amount of incumbrances, the issue of the policy without further inquiry is a waiver of the omission to state the amount." [13]

Representations. A statement of fact which is presented to the insurer as a basis for a contract of insurance is known as a *representation*. It has been defined as "a verbal or written statement as to certain facts made by the insured at the time of the formation of the contract, which constitutes an inducement for the insurer to enter into the contract." [14] A repre-

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[12] *Lynch* v. *Hamilton*, 3 Taunt. 37.
[13] *Phoenix Mut. Life Ins. Co.* v. *Roddin*, 120 U. S. 183, 30 L. Ed. 144.
[14] *Indiana Farmers' Live Stock Co.* v. *Byrkett*, 9 Ind. A. 443, 36 N. E. 779.

sentation is not part of the contract, but collateral to it. It is the basis upon which the contract is made, and which when taken away causes the contract to fall. Therefore, if a representation turns out to be false, the insurer may as a general rule avoid the obligation.

> "A representation is an oral or written statement of a fact or a condition affecting the risk, made by the insured to the insurer, and which precedes and is not a part of the contract, unless it is expressly stipulated that it shall be." (Sentinel Life Ins. Co. v. Blackmer, 77 F. [2d] 347)

The representation must be of a fact. Statements of belief, opinions, or judgment, although false, do not affect the policy, unless there is an intention to deceive, as in the case of one who purports to have a belief which he does not have. The same rule applies in respect to representations of future conduct. Promises, oral or written, made in connection with the insurance, are frequently termed *promissory representations.* Such statements may or may not be enforceable, but they clearly are not representations. For example, a company issues a policy of insurance on a house, relying upon the applicant's promise that he will live in the house. In the absence of fraud, his failure to live in the house does not afford ground for avoiding the contract.[15]

A false representation, in order to affect the contract, must be material. A representation is material when it induces the insurer to enter into the contract. The parties may, however, broaden materiality by agreement. For example, they may agree that any misrepresentation will render the contract voidable.[16]

> "A fact is material to the risk only when it is such that the insurer, acting in accordance with the usual custom and practices of insurance companies, would not have issued the policy had he known it." (Citizens' Ins. Co. v. Whitley, 252 Ky. 360, 67 S. W. [2d] 488)

It should be noted that intent has no bearing on the question. A representation of a material fact, which is not sub-

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[15] *Kimball* v. *Aetna Insurance Co.*, 9 Allen (Mass.) 540.
[16] *Cerys* v. *State Ins. Co.*, 71 Minn. 338, 73 N. W. 849.

stantially true, is ground for avoiding the contract, although the representation was innocently made. "It makes no difference that the misrepresentation was accidental, unintentional, and without any fraudulent intent, or even that the party insured was ignorant that such representation had been made. In either case, the ground of objection is the same; the insurers were misled." [17]

Warranties. A warranty is any assertion or promise stipulated in the policy or incorporated therein by reference, which if not literally and strictly true renders the contract of insurance voidable. An affirmative warranty is an assertion relating to existing or past matters. To illustrate, a statement of the insured that no insurance on the property has been canceled is an affirmative warranty.[18] A promissory warranty is an undertaking by the insured as to the performance or nonperformance of some future act after the policy has taken effect. For example, the statement that the premises are to be occupied or unoccupied during the period of insurance is a promissory warranty.[19]

A warranty differs from a representation in several respects. First, it is part of the contract, whereas a representation is an inducement collateral to the contract. Second, a warranty must appear upon the face of the policy or be incorporated therein by reference, whereas a representation may be oral or may appear in a separate paper. Third, it is of no importance whether or not the thing warranted is material, whereas a representation does not affect the contract unless it is material. Fourth, a warranty must ordinarily be strictly true or performed, whereas a representation is required only to be substantially true.

> " 'Merely calling the statements warranties does not make them so.' " (Williams v. Pacific States Fire Ins. Co., 120 Oreg. 1, 251 P. 258)

The strict enforcement of warranties frequently worked hardship on the insured. Accordingly, statutes modifying

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[17] *Goddard* v. *Monitor Mut. Fire Ins. Co.*, 108 Mass. 56.
[18] *Miller* v. *Commercial Union Assur. Co.*, 69 Wash. 529, 125 P. 782.
[19] *Stout* v. *City Fire Ins. Co.*, 12 Iowa 37.

their operation have been enacted in many states. Because of sharp practices by the insurer in early days, and of the abhorrence of forfeitures by the courts, warranties have been, in the absence of statutes, construed liberally in favor of the insured and strictly against the insurer. "It requires the clearest and most unequivocal language to create a warranty, and every statement or engagement of the assured will be construed to be a representation and not a warranty, if it be at all doubtful in meaning, or the contract contain contradictory provisions relating to the subject, or be otherwise reasonably susceptible of such construction. The courts, in other words, will lean against the construction of the contract, which will impose upon the insured the burdens of a warranty, and will neither create nor extend a warranty by construction." [20]

Waiver and Estoppel. The stipulations contained in the policy or rights in reference thereto may be waived by the party for whose benefit they are made, except when such waiver is against public policy. To illustrate, a statute declares that forfeiture for nonpayment of premiums is dependent upon the giving of a certain notice. A waiver of this notice by the insured cannot be claimed by the insurer.[21]

> "Provisions in a policy of insurance made for the benefit of the insurer may be waived by such insurer." (Webster v. Telle, 176 Ark. 1149, 6 S. W. [2d] 28)

Either party may also be estopped from claiming the benefits of such stipulations or rights. The difference between a *waiver* and *estoppel* is fundamental. The former is a voluntary relinquishment of a right, whereas the latter is involuntary. An estoppel arises when one has by his words or acts led another to rely upon them to his detriment. To illustrate, when the company issues a valid receipt for a premium, it is estopped later to deny that the payment was made in accordance with the agreed terms.[22]

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[20] *Alabama Life Ins. Co.* v. *Johnston*, 80 Ala. 467, 2 S. 125.
[21] *Baxter* v. *Brooklyn Life Insurance Co.*, 119 N. Y. 450, 23 N. E. 1046.
[22] *Tooker* v. *Security Trust Co.*, 26 App. Div. 372, 49 N. Y. S. 814.

"Estoppel cannot be invoked to impair the force and effect of a prohibitory law." (Gebelin v. Detroit Fire & Marine Ins. Co. [La. A.], 151 S. 260)

The power of the agent to waive the terms of the contract depends largely upon his authority. When limitations on the authority of an agent are contained in the policy, they are binding on the insured. Such restrictions are not binding, however, when they relate to an agent fully representing the company. For example, a general agent may waive stipulations in the policy, although it contains restrictions against such waivers.[23]

An agent authorized to solicit insurance, deliver the policy, and collect premiums could not "bind the company by a waiver of a warranty clause in the policy." (Champion v. Life & Casualty Ins. Co., 25 Ala. A. 101, 141 S. 363)

The question of parol waivers has caused considerable difficulty in the law of insurance. The parol evidence rule declares parol evidence is inadmissible to vary the terms of a written instrument. The rule is applicable to parol waivers prior to the issuance of the policy; consequently such waivers are unenforceable. Parol waivers made at the time of issuing the policy are enforced by some courts on the grounds of estoppel. For example, parol statements of the agent as to the validity of the representations made by the insured, are admissible in some courts on purely equitable grounds.[24] Parol waivers subsequent to the issuance of the policy are not subject to the parol evidence rule and may therefore be binding on the company.

QUESTIONS

1. On April 1 an insurance agent calls on Feil and makes an oral contract of insurance against loss of Feil's house by fire. As the agent is leaving, Feil states that he intends to build a garage in May of the following year. The agent thereupon orally agrees to insure the garage

[23] *Gwaltney* v. *Provident Savings Life Assurance Society*, 132 N. C. 925, 44 S. E. 659.

[24] *Union Mutual Life Ins. Co.* v. *Wilkerson*, 13 Wall. (U. S.) 222.

at that time. After the buildings are destroyed by fire, Feil brings an action on each policy against the company. The company contends that these agreements are unenforceable because of the Statute of Frauds. Is Feil entitled to recover for his losses?

2. Verry takes out a policy on his own life which requires annual payments of premiums. The first four premiums are promptly paid. Verry, having been unemployed for several months, is unable to pay the fifth premium. The company agrees to accept his note for this amount payable in four months. The note is unpaid at maturity, and Verry dies two months later. The executor of the estate of Verry brings an action against the company to recover on the policy. Is he entitled to judgment?

3. Retan who is about to be married takes out additional insurance for twenty thousand dollars on his life and pays the first premium. One week later the wedding is postponed indefinitely. Retan thereupon hastens to the office of the insurance company and demands the return of the premuim paid. When his demand is refused, Retan brings an action against the company to recover the amount of the premium. Is he entitled to judgment?

4. An explosion in a coal mine entombs nine miners by falling rock which cut off the exits. The remaining parts of the mine are filled with poisonous gases. A request is made for men to assume the perilous task of rescuing the entrapped survivors of the disaster. Ruxton, who is one of the three men selected from the volunteers to attempt the rescue, goes to an insurance agent and takes out a policy of insurance on his own life. He does not disclose the fact that he is about to descend into the mine with the rescue party. All three men are overcome by fumes in the mine and die shortly after being removed. An action on the policy is brought against the company. Is the company liable?

5. Varner applies for insurance on his apartment building. The company asks him, among others, the following questions: (a) Are there any liens on the property? (b) If so, for what amount? Varner answers the first question by stating that there are liens on the property, but he makes no answer to the second question. The policy is duly issued by the company. After the building is destroyed by fire, the company refuses to pay on the ground that Varner failed to state that there was a mortgage on the property for ten thousand dollars and a judgment lien for three thousand dollars. Varner brings an action on the policy against the insurer. Is he entitled to judgment?

6. Judd took out a policy of insurance that was issued by the insurer in reliance upon a false representation made by Judd. When the insurer sought to avoid the policy, it was contended that Judd had made the representation innocently. Was this a valid defense?

7. A company issued a policy on a house owned by Studebaker, relying on the latter's statement that the building was made of brick.

Studebaker had just recently gained title to the property by accepting it in part payment of an old debt. Not having seen the building for some time, he really believed it was constructed of brick. It turned out that the house was constructed of wood. After the building was destroyed by fire, Studebaker sued on the policy. Was he entitled to judgment?

8. Gubelman who applied for insurance on his store was asked whether he would keep a certain number of fire extinguishers on the premises. Gubelman replied that he would do so. A policy of insurance was issued by the company. After the building was destroyed, the company sought to avoid the policy on the ground of misrepresentation in that Gubelman did not keep the specified number of fire extinguishers on the premises. Was the action of the company justified?

9. Dodge insures a house which he owns against loss by fire for a period of one year. The policy contains a warranty that the house will be occupied during that period. Eight months later the tenant moves, and the premises remain vacant for the remainder of the year. During the period when the house is unoccupied, the building is destroyed. The company seeks to avoid the policy on the ground of breach of warranty. Dodge contends that the company is not entitled to avoid the policy because his statement was only a promise of future conduct. Is his contention sound?

10. Camp brought an action on a policy against the New England Mutual Insurance Company. The policy contained an affirmative warranty in respect to a certain fact. Camp proved that the warranty was substantially true. Was he entitled to judgment?

11. The contract of insurance on Chester's garage stipulates that either the company or the insured may cancel the policy upon giving ten days' notice. The company notifies Chester on July 10 that it intends to cancel the policy on July 15. On the latter date Chester surrenders his policy and secures a refund of premiums paid for the unexpired time. On July 17 the garage burns, and Chester demands the amount of loss from the company. When his demand is refused, Chester brings an action against the company to recover on the policy. Is he entitled to judgment?

12. Freeman was authorized to solicit insurance and to deliver the policy. He delivered to Merman a policy which stipulated that no agent had authority to waive any provision in the contract. Later, Merman alleged that at the time of delivery, Freeman had orally waived a certain provision in the policy. If true, was the insurer bound by such a waiver?

Part III—Fire Insurance

Nature of Fire Insurance. A contract under which one party for compensation agrees to indemnify another in the event of loss of property or damages thereto by fire is *fire insurance*. It has two outstanding characteristics. In the first place, the contract is strictly one of indemnity.[1] There is no liability on the part of the insurer, unless there has been a loss or injury due to the happening of the event specified.

> "Destruction by fire of the property described in the contract of insurance is not the contingency upon which the insurer promises to indemnify the insured. It is only when by fire the insured has sustained a loss that the insurer may be called upon to perform its contract of indemnity." (Draper v. Delaware State Grange Mut. Fire Ins. Co., 28 Del. 143, 91 A. 206)

A second feature of a policy of fire insurance is that it is a purely personal contract between the insurer and the insured. It is not of such character that it will run with the property insured. To illustrate, a person who insures his house against loss by fire later sells the premises. If the property is destroyed, the purchaser has no rights against the insurer by reason of such conveyance.[2] The basis for this rule is: "A contract for fire insurance is one of personal indemnity into which the character of the insured for trustworthiness and prudence enters as material to the risk." [3]

Kinds of Policies. There are many kinds of fire insurance policies, which are distinguished mainly by their terms. In some instances they differ in the method of distributing the insurance over the property. When the insurance covers several items of property, and the contract limits the liability of the insurer to a fixed amount on each article, the policy is known as a *specific* policy. On the other hand, when the insurance covers several items of property, but the contract does not allocate any specific sum to be the liability on any

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[1] *Mack* v. *Liverpool & London & Globe Ins. Co.*, 329 Ill. 158, 160 N. E. 222.
[2] *Simeral* v. *Dubuque Mut. Fire Ins. Co.*, 18 Iowa 319.
[3] *Key* v. *Continental Ins. Co.*, 101 Mo. A. 344, 74 S. W. 162.

particular article, the policy is usually described as a *blanket* policy.

> Blanket policies may be called "floating," "general," or "running" policies. They are also called "compound" policies. (Schmaelzle v. London & L. Fire Ins. Co., 75 Conn. 397, 53 A. 863)

Policies are also known as *valued* and *open* policies. A valued policy is one in which there is an agreed stipulation providing that the insured property is valued at a specified sum, payable in the event of loss. An open policy is one in which there is no agreed stipulation as to the specific value of the property, the amount payable being left to determination by proof or agreement in the event of loss. There may also be a combination of the open and valued policies. For example, the insurer may agree to pay a limited amount in case of a total loss, and an amount to be determined in the event of a partial loss. In such a case the policy is a valued policy as to the former, and an open policy as to the latter.[4] Fire insurance policies are as a general rule of the open or combination kind.

Risk Assumed. In fire insurance the risk assumed by the insurer is a loss occasioned by the destruction or injury to certain property by fire. There are three essential elements of a loss by fire.

In the first place, there must be an actual fire or burning. "Unless, therefore, there be actual ignition, and the loss be the effect of such ignition, the insurers are not liable. Not that the identical property to which the damage occurred should be consumed, or even ignited, but there must be a fire or burning which is the approximate cause of the loss. It is immaterial how intense the heat may be; unless it be the effect of ignition, it is not within the terms of the policy." [5]

> " 'Timber may be contracted from the heat of the sun and a loss thereby sustained, yet it is not a loss by fire.' " (Lavitt v. Hartford County Mut. Fire Ins. Co., 105 Conn. 729, 136 A. 572)

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[4] *Litc* v. *Firemen's Ins. Co.*, 119 App. Div. 410, 104 N. Y. S. 434.
[5] *Babcock* v. *Montgomery County Ins. Co.*, 6 Barb. (N. Y.), 637.

Second, the loss must be due to what is known as a *hostile* fire. The question of hostile fire is easily determined when the loss is caused by accident, such as a short circuit in electric wiring, but it is often difficult to determine when the fire is being used as an agency. A hostile fire in the latter case is one which to some extent becomes uncontrollable or escapes from the place in which it is intended to be. Thus, when soot is ignited and causes a fire in the chimney, the fire is hostile.[6] On the other hand, a loss caused by the smoke or heat of a fire in its ordinary container, which has not broken out or become uncontrollable, results from a friendly fire.

> Jewelry inadvertently placed in a furnace was not destroyed by a hostile fire. (Reliance Ins. Co. v. Naman, 118 Tex. 21, 6 S. W. [2d] 743)

In the third place, the fire must have been the immediate or the proximate cause of the loss or damage. A fire is the proximate cause of a loss when it occurs as a result of a reasonable continuity in the chain of events leading from the fire to the damages suffered. Hence a loss due to agencies which have been set in motion by a fire is a direct loss. For example, where the falling of a partition wall is caused by a fire in an adjacent building, the damage suffered is a risk assumed by the insurer.[7] In the absence of stipulations to the contrary, the risk assumed also covers loss caused by water used in extinguishing the fire, loss arising from the necessary removal of goods, loss due to theft of goods without negligence of the insured, and loss due to explosions occasioned by a hostile fire.

> The insurer is liable "when explosives are used as a means of stopping the spread of fire, such loss being adjudged to be mere incident of the fire like that resulting from the use of water, chemicals or other agencies to prevent the spread of fire." (Cook v. Continental Ins. Co., 220 Ala. 162, 124 S. 239)

It is customary for the insurer to insert provisions in the policy which limit his liability so as to exclude losses due to

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[6] *Way* v. *Abington Mut. Fire Ins. Co.*, 166 Mass. 67, 43 N. E. 1032.
[7] *Ermentrout* v. *Girard Fire & Mut. Ins. Co.*, 63 Minn. 305, 65 N. W. 635.

No. 77-112513 Stock Company

UNION CENTRAL
FIRE INSURANCE COMPANY
OF NEW YORK
• ORGANIZED 1834 •

Sum Insured					Total Premium
Fire	$5,500.00	Fire Rate •	$.88/72	Fire Premium	$ 47.60	$ 95.70
Fire Rent	$ 600.00	Fire Rent Rate	$.528	Fire Rent Premium	$ 3.17	
Windstorm	$5,500.00	Windstorm Rate	$ .64	Windstorm Premium	$ 35.20	
" Rent	$ 600.00	" Rent "	$ .230	" Rent "	$ 1.73	
Hail •	$5,500.00	Hail Rate •	$ .10	Hail Premium •	$ 8.00	

In Consideration of the Stipulations herein named and of Respective Premiums as above, Totaling
- - - - - - - - - - -Ninety-five and 70/100- - - - - - - - - - - - - - Dollars Premium,

Does Insure William B. Miller and Mildred C. Miller

for the term of five years

from the tenth day of December 19____, at noon (standard time),

to the tenth day of December 19____, at noon (standard time),

Against all direct loss or damage by Fire and Lightning, except as hereinafter provided, to an amount not exceeding
- - - - - - - - S I X T Y - O N E H U N D R E D - - - - - - - - - - - - - - - Dollars,

and against all direct loss or damage by Windstorm, Cyclone and Tornado, except as hereinafter provided, to an amount not exceeding S I X T Y - O N E H U N D R E D - - - - - - - - - - - - - - - Dollars,

to the following described property while located and contained as described herein, and not elsewhere, to-wit:

This contract consists of separate Fire and Windstorm policies covering in same amounts against loss or damage by Fire and loss or damage by Windstorm. The following form specifies the maximum amount of insurance covering the hazards assumed under either the Fire or Windstorm policies issued hereunder the same as if a separate form were hereto attached for each such policy, subject, however, to the terms, conditions and limitations covering any liability hereunder.

All situated 4001 Bramble Avenue
City, Town } of Cincinnati State of Ohio

*1 $ 5,000.00 *On* DWELLING HOUSE, *consisting of a* two *Story* frame *Building with* shingle *Roof,* occupied and to be occupied only for dwelling purposes.

*2 $ nil *On* HOUSEHOLD AND PERSONAL EFFECTS as hereinafter described.

*3 $ 600.00 *On the* RENTS and/or RENTAL VALUE of the above described dwelling house.

*4 $ 500.00 *On the* metal *roof* brick BUILDING, OCCUPIED AS A PRIVATE GARAGE AND/OR PRIVATE BARN.

*5 $ nil *On* HORSES AND COWS, subject to limitations on inside pages of policy, and

*6 $ nil *On* VEHICLES (excepting automobiles and motorcycles), Robes, Horse and Carriage Equipment, all only while contained in above described Private Garage and/or Private Barn.

*7 $ nil *On* SHEDS, OUTBUILDINGS AND FENCES on above described premises.

*8 $ nil *On*

$ 6,100.00 Total Insurance.

All items as described, defined and limited hereon and on the following pages hereof are hereby referred to and made a part of this policy of insurance.

The provisions printed on the third page of this policy relating to Rent and or Rental Value are hereby referred to and made a part hereof when a certain amount is specified and inserted in blank immediately preceding Item No. 2.

*No insurance attaches under any of the above items unless a certain amount is specified and inserted in blank immediately preceding the item.

This insurance shall also cover under Item No____ the fuel oil tank, including connections, located

Loss, if any, to be adjusted only with the insured named herein and payable to the insured and

as their respective interests may appear, subject, nevertheless, to all the terms and conditions of the policy

NOTE—For information only.—The above described dwelling is occupied, or to be occupied, by two families.

HAIL CLAUSE.—In consideration of $ 3.00 extra premium, this policy is hereby extended to cover direct loss or damage by Hail, subject to all its terms, conditions and stipulations and to all of such riders attached thereto, the total liability for loss or damage caused by windstorm, cyclone, tornado and or hail, either separately or together, not to exceed the total amount of this policy in effect at the time of loss. If there is other windstorm, cyclone and tornado insurance upon the property damaged, this Company shall be liable only for such proportion of any direct loss or damage caused by Hail as the amount hereby insured bears to the whole amount insured thereon, whether such other policy or policies contains a similar clause or not. It is a further condition of this insurance that this Company shall not be liable for loss or damage caused by Hail to hay, grain or straw, in fields or in stacks.

Not exceeding ten (10) per cent of the amount of any item of this policy on personal property shall cover also, as per above form, property of guests and servants, loss, if any, to be adjusted with and payable to the insured named in this policy.

Permission granted for such use of the premises as is usual and incidental to the occupancy as described herein, and to keep and use all articles and materials usual and incidental to such occupancy in such quantities as the exigencies of the occupancy require.

It is a condition of this insurance that the attached Awnings and Radio Equipment on the outside of the building are not covered under the Windstorm, Cyclone and/or Tornado insurance granted hereunder.

THE PROVISIONS PRINTED ON THE THIRD AND FOURTH PAGES OF THIS POLICY RELATING TO DIRECT PROPERTY LOSS ARE HEREBY REFERRED TO AND MADE A PART HEREOF.

This Policy is made and accepted subject to the foregoing and following stipulations and conditions, together with such other provisions, agreements, or conditions as may be endorsed hereon or added hereto, and no officer, agent, or other representative of this Company shall have power to waive any provision or condition of this policy except such as by the terms of this policy may be the subject of agreement endorsed hereon or added hereto, and as to such provisions and conditions no officer, agent, or representative shall have such power or be deemed or held to have waived such provisions or conditions unless such waiver, if any, shall be written upon or attached hereto, nor shall any privilege or permission affecting the insurance under this policy exist or be claimed by the Insured unless so written or attached. (The stipulations and conditions above referred to are set forth on the following pages of this policy.)

NOTE: This hail clause does not apply to item No. 3.

PROVISIONS REQUIRED BY LAW TO BE STATED IN THIS POLICY.—This policy is in a stock corporation, and is issued under and in pursuance of Sections 130, 131 and 132 of the Insurance Law of the State of New York.

In Witness Whereof, this Company has executed and attested these presents: but this policy shall not be valid unless countersigned by the duly authorized Agent of the Company at Cincinnati

F. B. Kline Secretary. H. B. Tyler President.

Countersigned at Cincinnati, Ohio this 10th day of December 19____

Charles A. Curtis Agent.

FIRE INSURANCE POLICY

fires arising under specified circumstances. Such exemptions usually exclude losses due to military power, civil authority, riots, insurrections, and invasions. They sometimes exclude losses due to other causes, such as thefts or explosions.

Cancellation. Neither the insured nor the insurer is entitled to cancel the policy in the absence of statutes or mutual agreement.[8] A statute may provide a certain method by which either party may exercise a right of cancellation. As in the case of other contracts, the parties may agree at any time to cancel the policy. They may also agree at the time of making the contract that one or both may terminate the relation, either at will or under certain conditions.

> When the policy provides for cancellation by giving five days' notice, "the motive for such cancellation is immaterial." (Camp v. Aetna Ins. Co., 170 Ga. 46, 152 S. E. 41)

When the contract or statute sets forth a method of termination, there must be full compliance with the requirements of such a provision. To illustrate, if the policy or statute provides that the right of cancellation may be exercised by the insured only upon payment of the premium or assessment, the amount must be paid in order to terminate effectually the policy.[9] Statutes and policies usually provide that cancellation is effective only after a certain number of days following notice. The standard policy requires five days' notice. Unless prescribed, any form of notice is sufficient if it unequivocally informs the other party that cancellation is intended.

> Cancellation provisions "cannot prevail over the terms of a statute." (Beka v. Breger, 130 Misc. Rep. 235, 223 N. Y. S. 726)

The requirements for a valid cancellation may, however, be waived by either party. For example, if the provisions of the statute or policy require three days' notice in the event of cancellation, and the insurer is canceling the policy, the

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[8] The general principles of cancellation in respect to fire insurance are the same as those in respect to life insurance.

[9] *Nelson* v. *Farm Property Mut. Ins. Assoc.*, 127 Iowa 603, 103 N. W. 966.

insured may waive this condition by surrendering the policy with the intention to cancel it.[10] It is usually provided in fire insurance policies that the amount of the premiums in excess of protection afforded will be returned upon termination of the relation. The standard policy reads: "If this policy shall be canceled as hereinbefore provided, or become void or cease, the premium having been actually paid, the unearned portion shall be returned on surrender of this policy or last renewal, this company retaining the customary short rate; except that when this policy is canceled by this company by giving notice, it shall retain only the pro rata premium." Whether the return or tender of the premium is a condition precedent to a valid cancellation, depends on the terms of the statute or policy. A majority of courts hold that the provision set out above requires a return or tender of the premium.

Liability of the Insurer. If the loss is not in excess of the amount of insurance stipulated in the policy, the insurer is liable for the amount of the loss. The loss may be partial or total. In the former situation the strict rule of indemnity applies, and the insurer is liable only for the actual loss. In the latter case the insured is entitled to the stipulated sum if the policy is a valued one. In some cases of total loss a statute may require a payment; this requirement has the same effect as a valued policy. To illustrate, the statute may read: "Whenever any policy of insurance shall be written to insure any real property, and the property insured shall be wholly destroyed without criminal fault on the part of the insured or his assigns, the amount of the insurance written in such policy shall be taken conclusively to be the true value of the property when insured, and the true amount of loss and measure of damages when destroyed."[11] It is therefore important in many instances to determine whether the loss is partial or total.

When there was a total loss of house and furniture, under a valued policy statute, "the amount of the insurance as fixed by the policy on them became due and payable on

[10] *Violette* v. *Pennsylvania Insurance Co.*, 92 Wash. 685, 161 P. 343.
[11] *Oshkosh Gas Light Co.* v. *Germania Fire Ins. Co.*, 71 Wis. 454, 37 N. W. 819.

the establishment of the loss." (Hartford Fire Ins. Co. v. Williams, 165 Miss. 233, 145 S. 94)

A total loss does not necessarily mean that the property has been completely destroyed. The loss is total if the unconsumed portion is of no value for the purposes for which the property was utilized at the time of the insurance. For example, if a building is only partly destroyed, but the standing walls are of no value in rebuilding the structure, the loss is total.[12] Moreover, although the remaining part can be used in restoring the property, the loss is also total if reproduction of that kind of building is prohibited by law.

There was a total loss when a "barn was not entirely consumed by the fire, but the roof was completely burned, the inside walls scorched and burned, and the few remaining upright portions of the wall were, according to the proof, totally worthless for any purpose except, perhaps, kindling wood." (Aetna Ins. Co. v. Weekley, 232 Ky. 548, 24 S. W. [2d] 292)

The amount of loss, in the absence of statute or agreement to the contrary, is the actual cash value at the time of the loss. This is the common-law rule which, aside from a statutory requirement, is usually incorporated in the policy. A disputed value, in the absence of agreement to refer it to appraisers, is a question of fact which must be decided by a jury. The insurer usually protects himself against an unfair valuation by reserving the option to restore the property. The cost of replacement, although evidence of the property value, is not, however, conclusive. As declared by one court, "the option to replace the machinery, if destroyed, was a reservation for the benefit of the company; they were not bound to adopt it. What it would cost to replace it was, therefore, not to furnish the rule for the damages which the company must pay to make good the loss. If this were to be held, it would be equivalent to enforcing the option as an obligation. It is stated in Angell on *Insurance*, Section 269, that the insurers have the privilege of making repairs or replacing the property if they see fit to do so; but if they elect not to do so,

[12] *Teter* v. *Franklin Fire Ins. Co.*, 74 W. Va. 344, 82 S. E. 40.

'they are liable only to pay a fair indemnity for the loss.' This shows that the estimated cost of a compliance with the option is not to be considered in assessing the amount to be paid on the loss." [13]

> "'Intention to rebuild or repair must be declared as prescribed by the policy, within the time fixed therein, or, if no time is fixed, in a reasonable time.'" (German Ins. Co. v. Hazard Bank, 126 Ky. 730, 104 S. W. 725)

The liability of an insurer is frequently decreased by the insertion of a coinsurance clause in the policy. A provision of this kind requires the insured to insure his property up to the full value or up to a certain value of the property, usually eighty per cent.[14] If he fails to do so, a loss must be shared by him to an extent measured by a percentage based upon the insurance actually carried and the insurance he was required to carry. Suppose the owner of a building valued at $20,000 insures it against loss to the extent of $12,000, and the policy has a coinsurance clause requiring insurance to be carried up to eighty per cent of the value of the property. In case of an $8,000 loss, the insured would not receive $8,000, but only $6,000, because he carried only three fourths of the amount required.

The amount payable to the insured may also be figured in this manner: since the insured was required by the eighty per cent coinsurance clause to insure the property up to eighty per cent of its value, and since the amount of insurance carried was only sixty per cent of the value of the property, the insurer is required to pay only 60/80 of the $8,000 loss, or $6,000, and the insured must bear 20/80 of the $8,000 loss, or $2,000.

The use of the coinsurance clause is the result of the fact that many persons insure their property for only a small percentage of its value because fires in by far the most instances do not cause a total destruction of the property insured. In some states, however, the use of such a clause is prohibited or limited.[15]

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[13] *Commonwealth Ins. Co.* v. *Sennett*, 37 Pa. 205.
[14] *Stephenson* v. *Agricultural Ins. Co.*, 116 Wis. 277, 93 N. W. 19.
[15] Compare Miss. Hemingway's Ann. Code 1927, Sec. 5850 with Wis. St. 1927, Sec. 203.22 and Iowa Code 1927, Sec. 8990.

Notice and Proof of Loss. One of the usual provisions of a policy of insurance is that the liability of the insurer shall be conditional upon the insured's furnishing notice of loss and proof of loss.[16] Notice may be required immediately or within a certain number of days subsequent to the loss. In the former event courts construe the term *immediately* to mean the exercise of reasonable diligence under the circumstances. For example, under a requirement of immediate notice, it was held to be sufficient when the insured acted within a reasonable time.[17] The form of the notice is immaterial, provided the insurer is actually informed of the loss. The policy or a statute may, however, specify a particular form. In this event notice must conform to the requirement. To illustrate, oral notice is insufficient when the policy or statute requires a notice in writing.[18]

> "'The word "immediate," like "forthwith," does not mean instantly; but immediate notice is notice within a reasonable time.'" (Greenwich Bank v. Hartford Fire Ins. Co., 222 App. Div. 219, 225 N. Y. S. 615)

Proof of loss must also follow the form prescribed by the terms of the policy or statute. When no particular form is prescribed, the insured must furnish sufficient evidence to enable the insurer to determine the amount of liability, if any. In some instances proof of loss is not necessary. For example, a person insures his house and later incurs a total loss. He gives notice of the loss, and the premises are inspected by the company. Under these circumstances formal proof of loss, unless demanded by the insurer, is unnecessary.[19]

> "It is settled law that the provision in a policy for proofs of loss must be complied with unless waived." (Bennett v. Cosmopolitan Fire Ins. Co., 50 F. [2d] 1017)

The effect of delay on the liability of the insurer depends on the terms of the policy or statute. It is often provided that the insured may forfeit the policy. In this event delay is

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[16] The general principles of notice and proof of loss in respect to fire insurance are the same in life insurance.

[17] *Ins. Co. of North America* v. *Brim*, 111 Ind. 281, 12 N. W. 315.

[18] *Cornell* v. *Milwaukee Mut. Fire Ins. Co.*, 18 Wis. 472.

[19] *Hower* v. *Susquehanna Mut. Fire Ins. Co.*, 9 Pa. Super. 153.

dangerous. In some cases, however, delay is excused, as when prompt compliance is rendered impossible by circumstances for which the insured is not responsible. To illustrate, a delay caused by the illness of the insured has been held excusable.[20]

Assignment. Fire insurance is a personal contract and, in the absence of statute, cannot be assigned before a loss without the consent of the insurer. The policy usually contains a provision that it may be avoided if the insured attempts to assign. In the absence of such a provision, an attempt to assign, however, does not render the contract voidable. Even when the policy includes a forfeiture clause, the clause applies only when the insured attempts to transfer his entire interest. It does not apply to equitable assignments. To illustrate, if the policy prohibits an assignment before loss, a pledge of the policy by the insured does not constitute a violation of the provision.[21]

If the insurer assents to an assignment of the policy to a purchaser of the property, the result is a new contract embracing the terms and conditions of the old. On the other hand, if an assignment is made after loss, or an equitable assignment takes place before loss, the assignee takes the contract subject to the defenses of which the insurer might have availed himself against the insured.

QUESTIONS

1. Fuller insured an apartment building that he owned against loss by fire. The policy contained a clause providing that in case of loss the insurer was entitled at its election to restore the property destroyed. After a loss, Fuller brought an action against the company to recover on his policy an amount of money equal to the cost of replacement. Was he entitled to judgment?

2. Fulrath insures his house against loss by fire. Later the premises are conveyed to Polk. Upon the destruction of the house by fire, Polk demands indemnity from the insurer. The company refuses to pay, and Polk brings an action on the policy which had been taken out by Fulrath. Is he entitled to judgment?

3. Wardwell, who lives in an apartment hotel, takes out insurance against loss by fire on several pieces of furniture which belong to him

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[20] *Niagara Fire Ins. Co.* v. *Scammon*, 100 Ill. 644.
[21] *Dickey* v. *Pocomoke City Nat'l Bank*, 89 Md. 280, 43 A. 33.

personally. The policy stipulates that in the event of loss the liability of the insurer will be no more than sixty dollars on each of three small chairs, one hundred dollars on one large chair, two hundred dollars on a desk, and five hundred dollars on a bookcase. What type of policy has been issued to Wardwell?

4. Doggett insures his house against loss by fire. The policy provides that the liability of the insurer is for the appraised amount of a loss caused by partial destruction, and for twenty thousand dollars in the event of a total loss. Does Doggett have an open policy?

5. Morgan's house was heated by steam which was conducted from the boilers of the city waterworks. One day the steam radiator became intensely heated, and the walls of the building were consequently injured. Morgan filed a claim against the insurer on his policy of fire insurance. The company refused to pay for the injuries and Morgan brought action on the policy. Was he entitled to judgment?

6. Burnham insures his summer cottage against loss by fire. The cottage is located in the mountains and is lighted by oil lamps. One evening when Burnham and his family are outside of the house, the wick of one lamp becomes out of order. As a consequence the walls and ceiling of the room are seriously injured by smoke emitting from the chimney of the lamp. Burnham files a claim on his fire insurance policy for the injuries done to the walls and ceiling. Is he entitled to indemnity?

7. A fire destroyed a six-story apartment building on the lot adjoining Griffith's property. During the course of the conflagration one of the walls of the building fell on Griffith's house and crushed in the roof. As Griffith's house was insured against loss by fire, he claimed indemnity from the insurer for the injury caused by the falling wall. Was he entitled to recover on the policy?

8. Logsdon owns a hotel which he insures against loss by fire for a period of five years. The policy provides that either the insured or the insurer may cancel the insurance by giving five days' notice. At the end of the second year Logsdon telephones the insurer that he wishes to cancel the policy. Later the company demands the third-year premium from Logsdon, alleging that the cancellation was ineffective because the notice was not in writing. Is Logsdon justified in refusing to pay the premium?

9. Hunter insures his house against loss from fire. The contract of insurance stipulates that the insurer is liable for the maximum amount of the policy in the event of total loss. One night a fire consumes all of the building except four walls. The insurer refuses to pay the maximum amount of the policy on the ground that Hunter has not suffered a total loss of the building. Hunter brings an action on the policy. Is he entitled to judgment?

Part IV—Life Insurance

Nature of Life Insurance. A contract under which the insurer, in consideration of a sum of money paid at once or to be paid later, agrees to pay a stipulated sum at the death of a person is known as *life insurance.* It differs from fire insurance in that it is not strictly a contract of indemnity.[1] Although it partakes of indemnity in the sense that one dependent on the insured may be protected to some extent against loss of that support, it must be remembered that the policy calls for the payment of a specified amount which may be more or less than the value of the anticipated benefits of the continuation of the life. It should be borne in mind that, generally speaking, it is impossible to evaluate a life in money.

> "The interest which one has in his own life, or in the life of another (unless it be that of a creditor), is difficult to estimate in dollars and cents; hence it is said that strict indemnity finds no place in life insurance." (Nye v. Grand Lodge A. O. U. W., 9 Ind. A. 138, 36 N. E. 429)

There is another feature of life insurance which precludes it from being strictly a contract of indemnity. Life insurance policies (with the exception of term policies, to be discussed later) increase in value yearly. At the end of a given time the value may be more or less than the amounts paid by the insured to the company, but in any event there is a real value which represents the accumulation of investments made by the company. Because of the plan of making payments of small sums which ultimately grow with interest to a large fund to be paid to the estate of the insured or to some recipient of his bounty, life insurance is considered by many persons as an investment device.

Kinds of Policies. A contract of life insurance may take one of many forms. The following types of policies are most common:

Ordinary Insurance. In this type of insurance, in return for fixed premiums payable at regular intervals, the policy

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[1] *Ante,* p. 418.

provides for the payment of a stipulated sum upon the death of the insured.

> Ordinary insurance is also known as "ordinary life," "general," or even "old line" insurance. (Haydel v. Mutual Reserve Fund Life Ass'n, 98 F. 200)

Limited-Payment Insurance. This type of insurance differs from the ordinary or straight life insurance in that the premiums are paid only during a limited period, such as ten, twenty, or thirty years, after which payments cease. Although the amount of premiums is larger, the insured pays a smaller sum, provided he lives the normal expectancy, because the probable accumulation of interest is considered in estimating the rate to be charged.

> Life insurance upon which all premiums have been paid is called "paid-up" insurance. (Nichols v. Mutual Life Ins. Co., 176 Mo. 355, 75 S. W. 664)

Term Insurance. In this type of insurance the insurer undertakes to pay a stipulated sum only in the event of the death of the insured during a specified period. This form of insurance is quite different from the ordinary or straight life insurance. In the latter the contingency is bound to happen, and the liability of the insurer is certain, although the time of payment is uncertain. In term insurance, since the liability of the insurer is uncertain, the amount of premiums is calculated on an entirely different basis. These policies are usually issued only for a short period and at a low cost.

> A policy of life insurance in force for one year, but renewable from year to year thereafter, "is a term insurance contract." (Rosenplanter v. Provident Sav. Life Assur. Soc., 96 F. 721)

Endowment Insurance. In this type of insurance the insurer undertakes to pay a stipulated sum when the insured reaches a specified age, or upon his death if that occurs earlier. Endowment insurance is therefore a combination of term and annuity insurance. It resembles the latter in that if the insured lives for a certain number of years, the amount stipulated becomes due and payable. This feature is not life insurance. The endowment insurance resembles the term pol-

CHARTER MUTUAL
LIFE INSURANCE COMPANY
OF HARTFORD CONNECTICUT

(CHARTERED IN 1851)

Agrees to Pay to

BENEFICIARY Helen R. Howard, Mother of the insured, if living at the death of the insured; otherwise, to Donald A. Howard, Father of the insured.

(subject to the beneficiary provisions in section 8)

FACE AMOUNT *The Sum of* ONE THOUSAND- - - - - - - - - - - - - - *Dollars,* upon receipt at its Home Office of this policy duly discharged together with due proofs of the death, while this policy is in force, of

THE INSURED JAMES R. HOWARD

or if such death is accidental under the conditions stated in Section 20 hereof,

DOUBLE INDEMNITY *The Sum of* TWO THOUSAND- - - - - - - - - - - - - *Dollars;* such sum, in either event, will be increased by the amount of any dividends or insurance additions and any Premium Deposit Fund then standing to the credit hereof and decreased by the amount of any indebtedness to the Company on account of or secured by this policy including any portion of the current policy year's premium unpaid at the death of the Insured; and, under the provisions of Section 21 hereof,

PERMANENT TOTAL DISABILITY

The Company Will Also Pay to the Insured During Permanent and Total Disability

An Income of TEN- *Dollars a Month*

and will waive the payment of premiums hereunder during such disability.

CHANGE OF BENEFICIARY The Insured has *** reserved the right to change the beneficiary as provided in Section 8 hereof.

This contract is made in consideration of the application herefor and of the

PREMIUMS FOR LIFE INSURANCE $ 15.97

DOUBLE INDEMNITY $ 1.25

PERMANENT TOTAL DISABILITY $ 2.83

Premium of TWENTY AND 05/100- - - - - - - - - - - - - - - - - - *Dollars,* payable on the first day of each January during the lifetime of the Insured unless this policy shall become paid up at an earlier date by dividends or the Premium Deposit Fund under the provisions of Sections 4 and 5 hereof.

The Privileges and Provisions on the second, third and fourth pages hereof are a part of this policy

In witness whereof, the Charter Mutual Life Insurance Company has by its President and Secretary signed, and by its Registrar, or an executive officer, countersigned, this policy in the City of Hartford, Connecticut, this first day of January 19

SECRETARY. PRESIDENT

Countersigned:

REGISTRAR.

Age 32

Ordinary Life Policy. Payable at Death of Insured
Permanent Total Disability Benefits and Double Indemnity for Fatal Accident
Premiums payable during Life of Insured unless previously paid up by dividends. Dividends apportioned annually.

1001

LIFE INSURANCE POLICY

icy in that the amount is payable in the event of the death of the insured during a specified period. It differs, however, in that since the liability for the stipulated amount is certain, the rates are higher.

Risks Assumed. The insurer frequently inserts a provision in the policy which excludes liability if death is due to certain causes, as, for instance, to the excessive use of drugs. In some instances courts have refused to enforce the obligation of the insurer when death was due to circumstances which rendered enforcement of the contract socially undesirable.

Suicide. In the absence of provisions in the statutes or policy, suicide in most states is held to be one of the risks assumed by the insurer. In a few jurisdictions, however, it is held that the insurer is not liable in case of suicide, because self-destruction is an implied exception to the risk, or because the contract is unenforceable on ground of public policy.

> "It is an inherent and fundamental part of every such contract that the insured shall not intentionally take his own life." (Shipman v. Protected Home Circle, 174 N. Y. 398, 67 N. E. 83)

The policy generally provides that the insurer is not liable if the insured commits suicide. In construing this condition, courts generally hold that the self-destruction must be the result of a voluntary act. To illustrate, if the insured dies by his own hand while insane, the insurer is liable under such a provision.[2] After courts had placed this construction on this condition, insurance companies adopted the practice of exempting the risk of suicide regardless of whether the insured was sane or insane. Statutes regulating the effect of suicide have been enacted in some states. The provisions of these statutes vary considerably. The legislation in some states provides that suicide renders the contract unenforceable. In other states the legislation provides that self-destruction is not a defense to the policy, except in the case of fraud. For example, if the insured contemplated suicide at the time he effected the insurance, the policy is unenforceable because of fraud.[3]

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[2] *John Hancock Mut. Life Ins. Co.* v. *Moore*, 34 Mich. 46.
[3] *Knights Templars', etc., Life Ins. Co.* v. *Jarman*, 187 U. S. 197, 47 L. Ed. 139.

One statute declares: "It shall be no defense after the policy has been in force one year that the insured committed suicide." (Harrington v. New York Mut. Life Ins. Co., 21 N. D. 447, 131 N. W. 246)

Violation of the Law. The policy usually contains a provision exempting the insurer from liability if the insured meets death while violating or attempting to violate the law. These provisions are sometimes construed to include the violation of any law, civil or criminal; sometimes they are construed to include only violations of criminal law; occasionally they are construed to include only felonies. In all cases, however, the death must be the natural result of the violation of the law. It is sometimes said that the unlawful act must be the proximate cause of the death. To illustrate, a person was struck by an automobile and killed while unlawfully carrying a deadly weapon concealed on his person. The insurer was liable, for the illegal act did not bring about the former's death.[4]

A company sought to avoid liability under a clause making the policy void "if the insured dies in consequence of his own criminal action." It was held that the insurer could not do so in view of another clause making the policy incontestable after three years. (Sun Life Ins. Co. v. Taylor, 108 Ky. 408, 56 S. W. 668)

Execution. Most policies include provisions limiting the insurer's liability when death is imposed by the state as punishment. In the absence of statutory provisions or provisions in the policy, courts apply different rules. In some jurisdictions, on the ground of public policy, courts deny recovery on the policy under such circumstances. In other states, however, they take the view that public policy requires a contrary holding. "Where a life insurance policy has been matured by the legal execution of the insured, the consideration having to do with the removal of temptation to, or restraint upon, crime among policyholders is not the only one with which the state is concerned. Over against the public good to be subserved by avoiding the policy contract upon the somewhat

[4] *Interstate Life Assur. Co.* v. *Dalton*, 165 F. 176.

tenuous theory that such forfeiture would tend to discourage the commission of capital crimes, is to be set the public good to be promoted by requiring payment of the insurance to the end that creditors be protected, commercial transactions safeguarded, and dependent women and children provided with the material necessities of life. Certainly the interest of the state in saving the dependents of an executed criminal from being a charge upon public charity or from having to seek a livelihood under conditions of poverty and degradation, calculated to make them an economic liability or a social and civil menace, is sufficiently obvious." [5]

Contrary to decisions in other states, some courts hold that an incontestable clause precludes the defense of "death by the hands of Justice." (Murphy v. Metropolitan Life Ins. Co., 152 Ga. A. 393, 110 S. E. 178)

War Activities. Policies frequently limit liability in the event of death in military or naval service during war. These provisions are construed as an exemption to the insurer only when war activities are the proximate cause of the death. When an insured was killed by an automobile accident at a great distance from the zone of battle, it was held that the provision did not apply and that the insurer was liable.[6]

Clauses exempting insurer from liability for death while engaged in military service are valid, and apply even "in case of an involuntary enlistment, as where the insured is inducted into the service under the federal draft laws." (Marks v. Supreme Tribe of Ben Hur, 191 Ky. 385, 230 S. W. 540)

Incontestable Clause. The insurer by voluntary act or by statutory compulsion places in most life insurance policies a provision known as an incontestable clause. This clause states that the policy is incontestable after a certain period, usually two or three years. The incontestable clause is in the nature of a short statute of limitations.

When a policy is incontestable after the lapse of a specified period, the defense of fraud is rightfully barred after the

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[5] *Weeks* v. *N. Y. Life Ins. Co.*, 128 S. C. 223, 122 S. E. 586.
[6] *Kelly* v. *Fidelity Mut. Life Ins. Co.*, 169 Wis. 274, 172 N. W. 152.

expiration of such period. The insurer has an opportunity to make an investigation for fraud before the policy becomes incontestable. This is not true, however, when the policy is incontestable from date of issue; hence many courts have properly held that in such case fraud may be set up as a defense despite the provision.

> A policy stating that "it shall be incontestable for any cause except misstatement of age" may nevertheless be contested for fraud. (Walsh v. Union Cent. Life Ins. Co., 108 Iowa 224, 78 N. W. 853)

An incontestable clause does not bar the insurer from setting up as a defense lack of insurable interest on the part of the holder of the policy. It is also held that the clause does not cover defenses that arise after the loss, such as the defense of failure to make proof of loss as required. The provision clearly does not apply to defenses excluded in the incontestable clause itself from the operation of such clause. On the other hand, an incontestable clause bars the insurer from setting up as a defense the breach of a mere condition that ordinarily would entitle the insurer to terminate its liability. For example, if the policy provides that the insurer may avoid its liability in case the insured commits suicide, the incontestable clause applies.[7]

> "The defense of failure to make proof of loss under the policy is not a contest of the policy itself, but it is an assertion by way of defense of a failure to perform a condition precedent to recovery." (Illinois Bankers' Life Ass'n v. Byassee, 169 Ark. 230, 275 S. W. 519)

Some courts have confused the defense of breach of a condition with the defense that a given risk is not covered by the policy. Other courts have properly held that an incontestable clause does not bar the insurer from setting up as a defense the fact that the policy does not cover certain risks, as for example, death by suicide. Thus a court, in respect to a policy with a rider excepting certain aviation risks, declared: "If an aviator, having such a policy and rider, should

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[7] *Northwestern Mutual Life Ins. Co.* v. *Johnson*, 254 U. S. 96, 65 L. Ed. 155.

meet his death as the result of service, travel, or flight in any species of aircraft, except as a fare-paying passenger, he could not recover, not because the policy, or any provision of it, was contested, but because the cause of death was not covered by the policy; to defend on such ground is not to contest the policy. A claim for fire loss could not be maintained under a life or accident policy. . . . Evidently the incontestable clause does not prevent contesting a claim which is not covered by the policy. A plaintiff can recover in accord with the contract he proves only." [8]

The Beneficiary. A person who receives the payment of money by the insurer upon the death of the insured is known as the *beneficiary*. The beneficiary may be the insured himself or, rather, his estate. In almost all cases, however, the beneficiary is a third person who is not a party to the contract of insurance.

The beneficiary (except as noted below) has a vested interest in the policy and may bring an action in his own name to enforce his interest. The vested interest of the beneficiary cannot be destroyed so long as the insurance remains in force. To illustrate, if a person who had insured his life in favor of another attempted to substitute a different beneficiary for the first beneficiary without the latter's consent, upon the death of the insured the first beneficiary would be entitled to the proceeds of the policy.[9]

> "A vested interest is where there is an immediate fixed right of present or future enjoyment." (McManus v. Peerless Casualty Co., 114 Me. 98, 95 A. 510)

The origin of this unusual interest of a beneficiary is not clear, but it is a right that is generally sustained by the courts. One court declares that the contract amounts to a gift which cannot afterwards be withdrawn.[10] In such jurisdiction it is therefore required that the policy be actually or constructively delivered in order to create a vested interest. Other courts

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[8] *Metropolitan Life Ins. Co.* v. *Beha*, 226 App. Div. 408, 235 N. Y. S. 501.
[9] *Breard* v. *New York Life Ins. Co.*, 138 La. 774, 70 S. 799.
[10] *Lemon* v. *Phoenix Mutual Life Insurance Co.*, 38 Conn. 294.

have based the rule on the theory of a trust being created or of the relation of principal and agent being established.

The beneficiary does not have a vested right in a policy which provides that the insured may change the beneficiary at will. Nor does he have such an interest in case of *fraternal* insurance, because of the nature of the contract. It should also be noted that when no reservation to change the beneficiary has been made, a change can, of course, be made if the party named as beneficiary consents to the change.

Assignment. A policy of life insurance under which the liability of the insurer has become fixed can as a general rule be assigned. Whether it can be assigned before maturity depends on the terms of the contract or on statutory provisions. In the absence of such stipulations to the contrary, the policy, unlike that of fire insurance, may be assigned conditionally or absolutely like any other instrument representing a right against another.

This is true even when the policy, in the event of loss, is payable to the insured's estate or to his personal representative, or when the policy is payable to a third party but permits the insured to change the beneficiary. If the policy does not contain such a reservation, the insured cannot make an assignment without the consent of the beneficiary. In either case the beneficiary may assign his interest under the policy.

The assignment of policies of life insurance is frequently governed by statutes. For example, the assignment may be required to be in writing.[11] In several states, when the rights of wives or children, as beneficiaries, are involved, statutes limit the insured's right of assignment of policies.

> In order that a wife who is the beneficiary of a policy may have the proceeds intact when a widow, statutes in some states disable her from assigning or "trafficking in any way with her insurance." (Ellison v. Straw, 116 Wis. 207, 92 N. W. 1094)

Life insurance policies generally provide that the policy may not be assigned unless the insurer has been notified of the assignment or has assented to it. This provision may, of course, be waived. Thus the acceptance by the insurer of pre-

[11] *Steele* v. *Gotten*, 115 Ga. 929, 42 S. E. 253.

miums, after an assignment, is strong, if not conclusive, evidence of the insurer's intent to waive the condition.[12]

Surrender Value. The rules as to cancellation of fire insurance policies, for the most part, apply to the cancellation of life insurance contracts. Ordinarily, however, a life insurance policy does not permit the insurer to cancel it at will.

It is usually provided in a life insurance policy, and sometimes by statute, that the insured is entitled to a certain sum in the event of his voluntary cancellation of the contract. This sum is known as the *surrender value* of the policy. It is important to notice, however, that the insured has no right to a surrender value in the absence of a statutory provision or of a provision in the policy. Frequently the right in question is made dependent on the fulfillment of certain conditions. For example, a policy may provide for a surrender value only after the policy has been in effect a specified time. The insured cannot demand the cash value before the lapse of this period.[13]

> When payable to one with a vested interest, a policy of life insurance "cannot be surrendered without the consent of the beneficiary." (Haskell v. Equitable Life Assur. Soc., 181 Mass. 341, 63 N. E. 899)

The cash value of a policy is sometimes said to be the amount of money, or its equivalent, which the company could afford to pay to be rid of the existing policy. This is not quite accurate. The surrender value is determined on the basis of its reserve value. The insurer can afford to pay the entire reserve value but, in order to discourage cancellation, usually fixes a smaller amount as the surrender value.

Rights of Creditors. Creditors of the insured are entitled to the proceeds of a policy of life insurance payable to the estate of the debtor, unless a statute exempts such proceeds or a part of them.[14] A more difficult question arises when the policy is payable to a third party. In this event it is well settled that an assignment by the insured is voidable at the option of the creditors if it is fraudulent as to them.

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[12] *Travelers' Ins. Co.* v. *Grant*, 54 N. J. Eq. 208, 33 R. 1060.

[13] *Blume* v. *Pittsburgh Life, etc., Co.*, 263 Ill. 160, 104 N. E. 1031.

[14] In fire insurance no particular problems are involved. After a loss, the creditors are entitled to the money as in case of other assets.

An assignment without a consideration to a sister by the insured, while insolvent, of a policy payable to his estate was set aside as a fraud on the insured's creditors. (Davis v. Cramer, 133 Ark. 224, 202 S. W. 239)

If the insured pays all the premiums from embezzled funds, some courts have held that the proceeds of the policy are subject to a trust for the entire amount of the embezzlement. On the other hand, if the insured pays premiums subsequent to the first from stolen funds, it has been held that the proceeds of the policy are subject to a lien only for the amount used to pay the premiums.

If the insured keeps alive a policy payable to third persons by paying the premiums while insolvent, courts are not in agreement as to the rights of the creditors of the insured. To illustrate, some courts hold, on the ground of public policy, that the creditors are not entitled to any of the proceeds in the absence of actual fraud.[15] This view favors protection to the family. On the other hand, some courts are more favorably inclined towards the creditors. After considering one case in which the creditors were given the surrender value of the policy at the time their money began to keep it alive, and another case in which the creditors were allowed only the amount of the premiums paid while the insured was insolvent, one court declared: "The object of such rules being to do exact justice between the contending parties and to distribute the fund according to their rights, it appears to us that neither of the rules above accomplishes the object; and inasmuch as the insurance money in contest in this case was the product of all the premiums paid, we think a just distribution of it would be obtained by declaring that Mrs. Robison (the beneficiary) should be decreed to have so much of the fund as was produced by the payment of premiums by her husband (the insured) when solvent, and the plaintiffs (the creditors), so much as the money or premium paid by Robison (the insured) when insolvent contributed to produce." [16]

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[15] *Central Nat'l Bank* v. *Hume*, 128 U. S. 195.
[16] *Pullis* v. *Robison*, 73 Mo. 201.

QUESTIONS

1. "Life insurance differs from fire insurance in that it is not strictly a contract of indemnity." What is meant by this statement?

2. Beale takes out a policy of life insurance which provides for the payment of ten thousand dollars in the event of his death. The contract stipulates the annual payment of premiums for a period of twenty years. What type of policy does Beale have?

3. Gilpatrick insures his own life for five thousand dollars. A few years later he commits suicide. The beneficiary of the policy brings action to recover the amount. Is the company liable?

4. Millard takes out insurance on his own life payable to his estate. After several months of nonemployment, he is persuaded to join Witzleben in an attempt to rob the home of Hicks, who is away. The caretaker, who is sleeping in the house during his employer's absence, discovers Millard and Witzleben in the house and shoots the former, who dies from the injury. Millard's executor brings an action to recover on the policy. Is he entitled to judgment?

5. Harbeson insures his own life for fifteen thousand dollars and names Jelinek as beneficiary. A few years later Harbeson changes the beneficiary, naming Brace in the place of Jelinek. Harbeson is killed in an automobile accident, and both Jelinek and Brace claim the insurance money. Who is entitled to the money?

6. Curry was named beneficiary in a policy taken out by H. D. Bruce on his own life. Bruce assigned the policy to Bebee in payment of an old debt. After the death of Bruce, Bebee and Curry both claimed the proceeds of the policy. Was Bebee entitled to the money?

7. Adler, who has insured his own life with his estate as the beneficiary, assigns the policy to Karen. After Adler's death the insurance company refuses Karen's demand for payment. Karen thereupon brings an action on the policy. Is he entitled to judgment?

8. Crockett insured his own life with his estate as the beneficiary. Ten years later he canceled the policy. Thereafter Crockett brought an action against the insurer to recover a portion of the premiums that he had paid. Was he entitled to judgment?

9. A policy of insurance on Chambers' life is found among his effects at his death. The proceeds of the policy are payable to his estate. The executor, having collected the money from the insurer, is undecided as to what he should do with it. The heirs of Chambers and his creditors both demand the money. Who was entitled to the money?

10. Mittern insures his life for ten thousand dollars and names his wife as the beneficiary. After paying the first ten premiums, Mittern becomes insolvent. He continues to pay the premiums while insolvent until his death. In all, fifteen premiums were paid. Creditors of Mittern brought an action to recover the amount of the policy. Were they entitled to judgment?

Part V—Motor Vehicle Insurance

Nature of Motor Vehicle Insurance. A contract under which the insurer, in consideration of a sum of money paid at once or to be paid later, agrees to indemnify a person against losses incidental to the ownership or to the operation of an automobile or a truck is known as motor vehicle insurance. Such losses may occur from risks that are met daily by the owners and the operators of motor vehicles. Some of these risks are the same as the risks covered by other forms of insurance policies. Motor vehicle insurance policies contain, however, many conditions, warranties, and exclusions that are peculiarly applicable to the ownership and the operation of automobiles and trucks.

Motor vehicle insurance is becoming more and more important, not only to the individual owner or driver of an automobile or a truck, but also to the members of society as a whole. There is, of course, a social interest in the individual loss to the owner of a motor vehicle arising from fire, theft, collision, or upset. There is even a greater interest in the appalling number of instances in which a loss arises out of an injury to the person or the property of one individual caused by the operation of a motor vehicle by another individual.

There are innumerable occasions in which the owner or the operator of a vehicle is financially unable to make redress for the injury to the person or the property of another for which he is responsible. For this reason, one state, at least, requires all owners or drivers of motor vehicles to carry insurance against liability for injuries to the person or the property of another.[1] Some states require such insurance to be carried by persons convicted of violating certain traffic regulations.[2] Many states require the owners or the drivers of motor vehicles carrying passengers for compensation to take out liability insurance.[3]

Bodily Injury Liability Insurance. In this type of insurance the insurer agrees to pay on behalf of the insured

[1] Gen. Laws of Mass. (1932), Ch. 90, Sec. 34A.
[2] Public Laws of R. I. (1927-28), Ch. 1040.
[3] Cahill's Consol. Laws of N. Y. (1930), Ch. 64A, Sec. 17.

all sums that the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages because of bodily injury (including death resulting from such injury) sustained by any person or persons, caused by accident and arising out of the ownership, the maintenance, or the use of the insured's automobile or truck. Such damages usually include both the expenses and the loss of services resulting from the injury.

> Under a statute, loss on account of bodily injury "does not include damage to the financial resources of the husband arising from a bodily injury to his wife." (Hayes v. Penn. Mut. Life Ins. Co., 228 Mass. 191, 117 N. E. 189)

The insured may be protected by the express terms of the policy against loss in case an accident occurs while other persons are using the vehicle, provided the actual use is with the permission of the insured. In such a case, however, the liability of the insurer is expressly limited so as not to apply in cases in which the user is one of certain specified persons. The protection may not apply: (1) to any person or organization with respect to any loss against which he has other valid and collectible insurance; (2) to any person or organization with respect to bodily injury to or the death of any person who is the named insured; (3) to any person or organization, or to any agent or employee thereof, operating an automobile repair shop, a public garage, a sales agency, a service station, or a public parking place with respect to any accident arising out of the operation thereof; and (4) to any employee of an insured with respect to any action brought against said employee because of bodily injury to or the death of another employee of the same insured, injured in the course of such employment in an accident arising out of the maintenance or the use of the automobile in the business of such insured.

> When the policy provides that the loss must be due to "use by the owner," the insurer is not liable in case of accident while the car is being driven by another, even though the owner is in the car. (Lucas v. Mueller, 183 Wis. 529, 198 N. W. 286)

Policies of bodily injury liability insurance contain various provisions that exclude the insurer from liability when in-

juries occur under specified circumstances. The most common exclusions are:

(1) Liability may be excluded for losses occurring while the vehicle is used in the business of demonstrating or testing, is used as a public or livery conveyance, is used for carrying passengers for compensation, or is used under a contract of rental, unless such use is specifically declared and described in the policy and a premium is accordingly charged.

> The clause excluding liability while vehicle is used "for rental or livery purposes," was held not to apply to the use of the vehicle by another in an emergency for an amount intended to be the actual cost of operation. (O'Donnell v. New Amsterdam Casualty Co., 50 R. I. 269, 146 A. 410)

(2) Liability may be excluded for losses occurring while the vehicle is used for the towing of any trailer not covered by like insurance in the insurance company, or while any trailer covered by the policy is used with any vehicle not covered by like insurance in the insurance company.

> When an accident occurred while the insured was driving his car with a trailer loaded with sheep, the insurer was not liable under a provision excluding liability while automobile is "used for towing or propelling trailers or other vehicles used as trailers." (Coolidge v. Standard Accident Ins. Co., 114 Calif. A. 716, 300 P. 885)

(3) The policy may not apply to liability for losses occurring while the vehicle is being operated by any person under the age of fourteen years or by any person in violation of any state or Federal law as to age applicable to such person or to his occupation. Thus, when the son of the insured, a minor who was about sixteen years of age but too young for a driver's license, while operating an automobile struck and killed another boy, the insurer under such a provision was not liable.[4]

(4) Most policies exclude liability for a loss occurring while a vehicle is being driven in any prearranged race or competitive speed test.

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[4] *Brock* v. *Travelers' Ins. Co.*, 88 Conn. 308, 91 A. 279.

Unless so provided in the policy, it is no defense to the insurer that the accident occurred while the car was being driven in violation of "a speed ordinance." (Taxicab Motor Co. v. Pacific Coast Casualty Co., 73 Wash. 631, 132 P. 393)

(5) Liability may be excluded for loss arising out of bodily injury to or the death of any employee of the insured while engaged in the business of the insured, other than domestic employment, or while engaged in the operation, the maintenance, or the repair of the vehicle. Liability may also be excluded for any obligation for which the insured may be held liable under any workmen's compensation law.

Liability may also be excluded for loss arising out of injury to "any person riding in or upon the automobile." (Fanslau v. Rogan, 194 Wis. 8, 215 N. W. 589)

(6) A provision of the policy may exclude liability of the insurer for any liability assumed by the insured under any contract or agreement.

The insurer was not liable when the insured, in violation of the terms of the policy, assumed liability for personal injuries arising out of a collision. (Kindervater v. Motorists Casualty Ins. Co., 120 N. J. L. 373, 199 A. 606)

(7) Liability may be excluded for any accident that occurs after the transfer, during the policy period, of the interest of the named insured in the automobile without the written consent of the insurance company.

The terms of the policy usually make the liability of the insurer conditional upon the giving of notice of an accident by the insured, or by someone acting in his behalf, to the insurer immediately or as soon as practicable. It has been held that such a provision does not require notice at the time of every trivial accident, but only in cases when an injury is apparent. Thus it was held that the insured was not required to give notice at the time of an apparently trivial collision with a bicycle, but only when the accident had taken the aspect of a claim for damages.[5] The provision for immediate notice is ordinarily construed by courts to mean reasonable notice.

[5] *Chapin* v. *Ocean Accident and Guarantee Corp.*, 96 Nebr. 213, 147 N. W. 465.

The notice is required to contain particulars sufficient to identify the insured, to contain reasonably obtainable information respecting the time, the place, and the circumstances of the accident, and to give the names and the addresses of the injured person and of any available witnesses. The insured is also required to give the insurer immediate notice of any suit or claim brought against him. The terms of the policy usually require also that the insured co-operate fully with the insurer, upon request attend hearings and trials, give testimony, and in other ways assist in effecting a settlement.

> Co-operation by the insured was not required when the insurer "wrote disclaiming liability because of delay in notice." (Hunter v. Hollingsworth, 165 Va. 583, 183 S. E. 508)

The insurer ordinarily promises to defend any suit brought against the insured based upon an alleged injury that is covered by the policy. The insurer promises also to pay all premiums on bonds to release attachments for an amount not in excess of the liability on the policy. In this connection, a provision of the policy may be to the effect that the bankruptcy of the insured will not relieve the insurer of its obligations under the policy.

The liability of the insurer is limited by the amount stated in the policy. The liability of the insured, however, is not limited. The insured may carry whatever amount of protection he desires, although the insurance company makes an additional charge for assuming additional liability.

Property Damage Liability Insurance. In this kind of insurance the insurer agrees to pay on behalf of the insured all sums that the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages because of injury to or the destruction of property, caused by accident and arising out of the ownership, the maintenance, or the use of the insured's automobile or truck. The policy usually covers damages that include loss of use of the motor vehicle or other property that was injured or destroyed.

Under some policies protection is extended to the insured when other persons are using the vehicle with the permission

of the insured. Such protection, however, as in the case of some policies of bodily injury liability insurance, may not apply to certain specified persons or organizations. Such excepted persons or organizations may be (1) a user who is protected by other insurance or (2) a user, or his agent or employee, who is operating a motor vehicle repair shop, a public garage, a sales agency, a service station, or a public parking place with respect to any accident arising out of the operation thereof.

> Employees of a "public gasoline filling station" are denied protection under a clause referring to employees of a "public service station." (Alberga v. Pennsylvania Indemnity Corp., 114 Pa. Sup. 42, 173 A. 697)

Exclusions of one kind or another are contained in the various policies of property damage liability insurance. The most common exclusions are:

(1) The policy may not apply to liability for injuries to or the destruction of property owned by the insured, property transported by the insured, or property rented to, leased to, or in charge of the insured.

> Exclusion of liability with respect to property in the custody of the insured is because "both the frequency of accident and the opportunities for fraud create a high hazard and make the risk undesirable at least at the rate charged for the ordinary coverage." (Parry v. Maryland Casualty Co., 228 App. Div. 393, 240 N. Y. S. 105)

(2) Liability may be excluded for losses occurring while the vehicle is used in the business of demonstrating or testing, while it is used as a public or livery conveyance, or while it is used to carry passengers for compensation.

> When it appears that there were passengers, the insured is not liable unless it is shown "that they were all carried free." (Raymond v. Great American Indemnity Co., 86 N. H. 93, 163 A. 713)

(3) The policy may not cover liability for losses occurring while either a trailer or the vehicle towing it is not covered by like insurance in the company.

Insurer was not liable when a truck with trailer attached struck the rear end of a Ford automobile. (Maryland Casualty Co. v. Adams, 159 Miss. 88, 131 S. 544)

(4) The policy may exclude liability for losses occurring while the vehicle is being operated by any person under the age of fourteen, or by any person in violation of any state or Federal law as to age applicable to such person or to his occupation. It has been held, however, that such a provision did not apply when a boy of eleven years, who had been left to watch a car, tried to move the vehicle and drove the machine into a store front, breaking the plate glass.[6]

(5) The policy usually excludes liability for losses occurring while a vehicle is being operated in any prearranged race or competitive speed contest.

In the absence of a provision in the policy, it was no defense to the insurer that the insured was exceeding the speed law when his car collided with and practically destroyed the car of another person. (Fireman's Fund Ins. Co. v. Haley, 129 Miss. 525, 92 S. 635)

(6) The policy commonly excludes liability of the insurer when liability is assumed by the insured under any contract or agreement.

The conditions that must be met by the insured are usually the same as in policies of bodily injury liability insurance. In fact, the two forms of insurance are commonly embodied in the same policy. Hence the insured must give the insurer notice of the accident immediately or as soon as practicable, as well as immediate notice of a suit or a claim brought against him. The insured is also required to co-operate fully with the insurer, to give testimony, and to assist in other ways in the settling of the case.

"As between the assured and the insurance company, the unexcused failure of the assured to comply with the condition of the policy requiring co-operation serves to prevent his recovery under the policy." (Finkle v. Western Automobile Ins. Co., 224 Mo. A. 285, 26 S. W. [2d] 843)

The insurer promises to pay the premiums on bonds to release attachments for an amount that does not exceed the

[6] *Aetna Casualty & Surety Co.* v. *Etoch*, 174 Ark. 409, 295 S. W. 376.

liability of the insurer. Another promise is to defend the insured in any suit brought for an alleged injury to or destruction of property covered by the policy. Here, also, there may be a provision in the policy to the effect that the obligation of the insurer under the policy is not affected by the bankruptcy of the insured.

Collision or Upset Insurance. In this type of insurance the insurer agrees to pay for any direct loss arising from damage to or the destruction of the insured's motor vehicle or its operating equipment while attached thereto, caused by accidental collision or upset.

> Collision insurance may provide "that 'damages resulting from collision due wholly or in part to upsets' shall be excluded." (Harris v. American Casualty Co., 83 N. J. L. 641, 85 A. 194)

The policy may exclude liability on the part of the insurer for certain losses. The most common exclusions are:

(1) The policy usually stipulates against liability for loss of the use of the vehicle, loss by depreciation, and loss of robes, wearing apparel, or other personal effects.

(2) Liability may be excluded for loss due to wear and tear, mechanical or electrical breakdowns, failures, or breakages, freezing, or damage to tires, unless directly caused by collision or upset.

(3) The policy may exclude liability for loss while the vehicle is being operated by any person under the age fixed by law or in any event under the age of fourteen years. In this connection, however, it has been held, when a minor son of the insured was driving the car at the time of the accident, that the insurer was liable if there was no casual connection between the fact that a minor was driving and the accident.[1]

(4) The policy may exclude liability for loss occurring when the vehicle is being operated while rented under contract or lease, while used in any illicit or prohibited trade or transportation, while engaging in any prearranged race or competitive speed contest, or while subject to any lien, mort-

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[1] *Hessley* v. *Union Indemnity Co.*, 137 Miss. 537, 102 S. 561.

gage, or other incumbrance not specifically described in the policy.

(5) Liability may be excluded for a loss occurring while the vehicle is used in the business of demonstrating or testing, or while the vehicle is being used as a public or livery conveyance for carrying passengers for compensation.

(6) The policy may exclude liability for loss occurring while the vehicle is used for the towing of any trailer not covered by like insurance in the company, or while any trailer covered by the policy is used with any vehicle not covered by like insurance in the company. This and similar provisions are held to be valid because of the added hazard arising from such use.[8]

A policy of this kind ordinarily requires the insurer to pay the actual cash value of the property at the time of the injury to or the destruction of the property, or the cost of its suitable repair or replacement not in excess of the cash value. The loss is ascertained or estimated with a deduction for depreciation. The amount of the loss is to be determined by the insurer and the insured when possible, otherwise by three appraisers. One appraiser is selected by the insurer and one is selected by the insured. The third appraiser is selected by the appraisers selected by the parties. The compensation of the appraisers and other expenses are divided between the insurer and the insured. A provision of the policy usually gives the insurer the right to replace the property injured or destroyed or to pay to the insured in money the amount of the loss determined.

> " 'Replacement' as thus used means, in our opinion, the restoration of the property to its condition prior to the injury." (Rossier v. Union Automobile Ins. Co., 134 Oreg. 211, 291 P. 498)

Some policies have a provision for certain deductions from the amount specified as the liability of the insurer. In such instances the insurer is liable only for the amount in excess of the deduction specified in the policy, which is usually $50

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[8] *Connor* v. *Union Automobile Ins. Co.*, 122 Calif. A. 105, 9 P. (2d) 863.

or $75. In other words, the insured has to pay the first $50 (or any other agreed amount) of the loss, and the insurer pays the remainder up to the amount specified in the policy. Each accident is deemed to be a separate claim, and the liability of the insurer in each case is subject to such deduction.

The policy usually requires the insured to give to the insurer notice of the accident immediately or as soon as practicable. The insured is also required to submit proof of loss and to give information in respect to such facts as are specifically set forth in the terms of the policy.

A provision of the policy ordinarily requires the insured to co-operate fully with the insurer in effecting a settlement, to attend trials, to give testimony, and to assist the company in other ways. The insured is required also to give the insurer opportunity to examine the vehicle before repairs are undertaken or physical evidence of the injury or destruction is removed.

Theft, Robbery, and Pilferage Insurance. In this kind of insurance the insurer agrees to pay the insured for certain losses arising from the theft, robbery, or pilferage of a motor vehicle or its equipment. Such losses include any injury to or destruction of the automobile or truck that is caused by theft, robbery, or pilferage.

To recover under a policy of this kind, the taking must be such as to constitute a theft; hence it is usually held that the taker must have a criminal intent to deprive the owner of the motor vehicle.[9] It has therefore been held that merely driving the car of another does not constitute theft within the meaning of the policy. The same result was reached when one party took an automobile for temporary purposes without the consent of the owner.

In this connection, however, it should be noted that in some states there are statutes which declare that the taking of an automobile from any place for the use and the purposes of the taker without the consent of the owner constitutes a theft.[10]

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[9] *Kovero* v. *Hudson Ins.*, 192 Minn. 10, 255 N. W. 93.
[10] Laws of New York 1922, Ch. 500.

When one who was teaching the insured to drive, with no intent to deprive the insured of the vehicle, wrongfully used the car for his own purposes and wrecked the machine, there was no theft for which the insurer was liable. (Ledwinka v. Home Ins. Co., 139 Md. 434, 115 A. 596)

Policies of this kind usually exclude liability for the loss of tools or repair equipment unless the entire vehicle is taken. Other common exclusions are loss of use, depreciation, and loss of robes, wearing apparel, and other personal effects. Losses due to wear and tear, mechanical or electrical failures or breakages, freezing, and injuries to tires, unless directly caused by and resulting from theft, robbery, or pilferage, are also usually excluded.

Exemption from liability for loss of robes and coats does not apply only to automobile robes and coats, but it includes a fur coat taken from a car "while the automobile was standing on the street at Miami, Florida." (Hall v. Royal Ins. Co., 123 Misc. Rep. 152, 204 N. Y. S. 828)

There are many other exclusions or conditions that vary in the different policies. A few of these will be noted to indicate the trend. They are:

(1) A provision of the policy may exclude liability for a loss that occurs while the vehicle is in the possession of one to whom the insured has voluntarily given possession, or is in the possession of certain parties named in the policy and such party causes the loss. Thus, under such a provision, recovery on a policy was denied when the loss was the result of an act of a conditional vendee.[11] Under some provisions it is immaterial that the possession was given to another as the result of false pretense, trick, or scheme. Under other policies, however, the gaining of possession by one who falsely represents himself to be a prospective buyer constitutes a theft within the meaning of the policy.

When a person hired a car for a few hours but failed to return the vehicle, it was held that there was a theft "within the purview of the policy." (Simpson v. Palmetto Fire Ins. Co., 145 S. C. 405, 143 S. E. 184)

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[11] *Fiske* v. *Niagara Fire Ins. Co.*, 207 Calif. A. 290, 278 P. 861.

(2) Liability for losses occurring while the vehicle is used for carrying passengers for compensation may also be excluded.

(3) A provision may exclude liability for a loss occurring when the vehicle is rented or leased.

> Exemption from liability for loss while the automobile was being rented does not cover theft by the person who rented the car. (Fidelity Phoenix Fire Ins. Co. v. Oldsmobile Sales Co., Tex. Civ. Ap. 261 S. W. 492)

(4) A provision may exclude liability for a loss that occurs while the vehicle is stored in a specified place, such as "an open lot or unroofed space or in any building not securely enclosed and locked when unattended." Under such a provision an insurer was not liable when a car was stolen, during the night, while stored on an open lot awaiting repairs in the insured's adjoining garage.[12]

(5) A provision may exclude liability in the event of theft by a person in the service or in the household of the insured. Under such provisions it has been held that the insurer was not liable in case of theft by a chauffeur of the insured,[13] and in case of theft by a nephew who was temporarily visiting his uncle, the insured.[14]

The amount of the loss for which the insurer is liable under a policy of this kind is the actual cash value of the property at the time it was injured or stolen. This value is agreed upon by the insured and the insurer; otherwise it is left to the determination of three appraisers, as in the case of collision or upset insurance. If the property is recovered, the insurer has a right to return the stolen automobile or its equipment, with compensation for physical damage, at any time before actual payment for the loss has been made under the policy. In this connection, if the policy makes no provision for the time of payment, the insurer is required to return the vehicle within a reasonable time.[15]

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[12] *Berry Chevrolet Co.* v. *Automobile Ins. Co.*, 188 Minn. 123, 246 N. W. 547.

[13] *Dairy Fertilizer Co.* v. *American Ins. Co.*, 18 La. A. 502, 138 S. 154.

[14] *Rydstrom* v. *Queen Ins. Co.*, 137 Md. 349, 112 A. 586.

[15] *Martoni* v. *Massachusetts F. & M. Ins. Co.*, 106 Conn. 519, 138 A. 462.

> When a truck was located seventy-five days after theft, the insurer, having bound itself to pay within sixty days after proof of loss, "could not, by a demand on plaintiff to sue out a writ of replevin, indefinitely postpone the time of payment until the termination of the replevin suit." (Cancilla v. Fireman's Fund Ins. Co., 277 Pa. 223, 120 A. 824)

A policy of this kind usually requires the insured to give notice of loss to police officers and to the insurer, and to furnish proof of loss within a specified period. The insured is also required to assist the insurer in recovering the stolen property, to assist in necessary actions or suits, and to cooperate in other ways. These requirements are usually made conditions to recovery on the policy.

Fire, Lightning, and Transportation Insurance. In this type of insurance the insurer agrees to pay for any loss arising out of injury to or the destruction of a motor vehicle or its equipment caused by fire due to any cause, by lightning, or by the stranding, burning, sinking, collision, or derailment of any conveyance in or upon which the automobile or the truck is being transported.

> Collision of conveyance upon which automobile is being transported includes collision of an "elevator with the bottom of the elevator shaft." (National Fire Ins. Co. v. Elliott, 7 F. [2d] 522)

Exclusions in the various policies limit to some extent the liability of the insurer. The most common exclusions are:

(1) The policy may not apply while the vehicle is being operated or manipulated in any race or speed contest.

(2) The policy may not apply while the automobile or the truck is being driven by any person prohibited by law from driving a motor vehicle, by any intoxicated person, or by any person under the age of sixteen years.

(3) The insurer may not be liable for losses occurring while the vehicle is rented, loaned, or leased, or while the machine is carrying passengers for hire. The policy may contain a warranty that the machine will not be used to carry passengers. Such a provision, if broken, will exclude liability regardless of when the injury or the destruction occurs. Thus

it was held that the breach of a warranty that a car would not be used for carrying passengers entitled the insurer to avoid liability under the policy.[16]

(4) The policy may not apply while the vehicle is being driven by any person other than the insured, a member of his immediate family, or his paid driver.

(5) A provision may expressly exclude liability for any loss or damage purposely inflicted by the insured or by anyone at the insured's request.

> Under a clause exempting liability in case of loss due to failure "to use all reasonable means to save and preserve the property," an innocent partner cannot collect when the other partner wilfully set fire to the automobile. (Bellman v. Home Ins. Co., 178 Wis. 349, 189 N. W. 1028)

(6) A provision may exclude liability for any loss occurring while the vehicle is being operated contrary to law. Thus it was held under such a provision that the insurer was not liable for a fire occurring while the machine was being driven without proper registration and with registration plates not belonging to the insured, contrary to law.[17]

The amount for which the insurer is liable under a policy of this kind is the same as in the case of theft insurance, namely, the actual cash value, and it is determined in the same manner. The requirements of the insured in respect to notice and proof of loss and in respect to co-operation with the insurer are also similar to the requirements in a policy of theft, robbery, and pilferage insurance. As a matter of fact, the two kinds of insurance are commonly embodied in one policy.

QUESTIONS

1. Kendall took out a policy of bodily injury liability insurance. Thereafter he drove his car in such a way that he struck and injured Christal. A judgment was obtained by Christal against Kendall. The

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[16] *Orient Ins. Co.* v. *Van Zandt-Bruce Drug Co.*, 50 Okla. 558, 151 P. 323.

[17] *Standard Automobile Ins. Ass'n* v. *Neal*, 199 Ky. 699, 251 S. W. 966.

insurer refused to pay the full amount of the judgment on the ground that such damages included damages for loss of service. Kendall brought an action against the company to recover the full amount of the judgment. Was he entitled to judgment?

2. Edward Neville accepted a challenge to race his automobile on a certain day against a car driven by Mott. During the race Neville's car got out of control and ran into some assembled spectators. The company in which Neville was insured against bodily injury liability refused to pay under the policy. Neville brought an action against the company for breach of contract. Was he entitled to judgment?

3. Milford took out a policy of property damage liability insurance. Thereafter he failed to stop his automobile properly and ran through the rear of his garage, causing a loss of $50. The insurer refused to pay for the property damage, and Milford brought an action to recover for breach of contract. Was he entitled to judgment?

4. Henry Quaille operated his truck in such a manner that he collided with an automobile owned and driven at the time by Morrison. Quaille admitted fault and responsibility for the accident, and he entered into an agreement with Morrison whereby he promised to pay $165 as damages. Thereafter the company in which Quaille carried property damage liability insurance refused to pay the agreed sum. Quaille brought an action against the company to recover damages for breach of contract. Was he entitled to judgment?

5. Carver took out a policy of collision or upset insurance with a provision providing that the insurer would pay for any loss in excess of a $75 deduction. Carver's car was injured in a collision to the extent of $200. He paid $75 of the damage and the insurer paid $125. Thereafter, in the same month, Carver was blinded by approaching lights and drove his car into a ditch causing damage to his car to the extent of $435. The company refused to pay $435 upon demand by Carver, who thereupon brought an action to recover the sum. Was he entitled to judgment?

6. Elders took out a policy of collision or upset insurance on a truck. Thereafter the car was injured in a collision with a freight train. The company offered to replace the parts of the truck that had been injured, but Elders brought an action to recover the cash value of such parts. Was he entitled to judgment?

7. Merle Carroll insured his automobile against loss by collision or upset, but he did not insure his trailer, which he towed with the car. While he was on a vacation trip, the automobile was injured as the result of a collision. The insurer refused to pay the amount of the damage. Carroll brought an action to recover under the policy from the insurer. Was he entitled to judgment?

8. O'Neil insured his automobile against theft, robbery, and pilferage. While his car was parked in front of the home of one of his friends,

a tool kit was stolen from the machine. The insurer refused to pay for the loss. O'Neil brought an action against the company to recover under the policy. Was he entitled to judgment?

9. The automobile of Brookins was stolen. Brookins gave notice of the loss and met other requirements of a policy of theft, robbery, and pilferage insurance. Within a few days the car was recovered in an injured condition. The insurer returned the vehicle but refused to pay for the injuries to the property. An action was brought by Brookins against the company to recover on the policy. Was he entitled to judgment?

10. A truck belonging to Denton was destroyed by fire. The insurer of the truck against loss by fire refused to pay the cost of a new vehicle of the same make, which was demanded by Denton. Denton brought an action on the policy to recover such an amount from the company. Was he entitled to judgment?

CASES FOR REVIEW

1. The Glen Falls Insurance Company issued to V. M. Johnson a policy of insurance against loss to an automobile resulting from fire, lightning, or, while being transported in any conveyance, the stranding, sinking, collision, burning, or derailment of such conveyance. One morning between midnight and four in the morning, Johnson placed the car on the Yohannah Ferry for transportation over the Pee Dee River. The automobile, for some unaccountable reason, suddenly started and ran off the ferry, which was then in the middle of the stream. Johnson brought an action to recover on the foregoing policy. Was he entitled to judgment? (Johnson v. Glen Falls Ins. Co., 131 S. C. 253, 127 S. E. 14)

2. The Farmers' Mutual Fire Insurance Company of Georgia issued a policy of fire insurance to J. A. Cox. The policy provided that either party "may at any time be released from the obligation of this policy by giving the other party 30 days' notice of such intention." Thereafter Cox entered into an agreement with the company to cancel the policy at once. Was the policy canceled immediately? (Cox v. Farmers' Mut. Fire Ins. Co., 133 Ga. 175, 65 S. E. 409)

3. The Equitable Life Assurance Company of the United States issued a policy of insurance for the sum of $2,000 on the life of John A. Fludd. At the time when the policy was delivered, the insurance company had knowledge of facts that rendered the policy void at its election. Fludd was killed, and his widow, Minnie M. Fludd, brought an action to recover on the policy. The company sought to avoid liability by showing the foregoing facts. Was Mrs. Fludd entitled to judgment? (Fludd v. Equitable Life Assur. Co., 75 S. C. 315, 55 S. E. 762)

4. The Aetna Life Insurance Company issued to Mrs. Rosina W. Kimball a policy of insurance for $5,000 on her life, with her husband, Benjamin G. Kimball, named as beneficiary. After the death of Mrs. Kimball, the insurer brought an action against Kimball, Henry J. Conley, and Theodore Kerr, all claimants of the proceeds of the policy, to determine to whom the money should be paid. It was contended that a policy of life insurance is a contract of indemnity. Do you agree? (Aetna Life Ins. Co. v. Kimball, 119 Me. 571, 112 A. 708)

5. The Retail Hardware Mutual Fire Insurance Company of Minnesota issued to Theresa La Motte a policy of insurance against the theft of an automobile. Mrs. La Motte's nephew, Joe La Motte, who was not a member of her household, took her car from the garage without authority for the purpose of taking some girls for a ride. While returning from the ride, the car was wrecked as the result of skidding on wet pavement. Mrs. La Motte brought an action against the insurer to recover on the policy. Was she entitled to judgment? (La Motte v. Retail Hardware Mut. Fire Ins. Co., 203 Wis. 41, 233 N. W. 566)

6. The Fidelity & Casualty Company entered into an oral agreement with the Ballard & Ballard Company, whereby it agreed to pay certain sums of money in the event of an injury to or the death of an employee in the course of his employment. Albert Heil, an employee of the Ballard & Ballard Company, was killed while discharging his duties. The Ballard & Ballard Company brought an action under the common law against the insurer to recover on a contract of insurance. Was it entitled to judgment? (Fidelity & Casualty Co. v. Ballard & Ballard Co., 105 Ky. 253, 48 S. W. 1074)

7. The New Hampshire Fire Insurance Company issued to the Northern Timber Company a policy of fire insurance. The policy, with the consent of the insurance company, was assigned to William Wilms. In an action brought by Wilms against the insurance company, it was contended that the assignment was in effect a new contract. Do you agree with this contention? (Wilms v. New Hampshire Fire Ins. Co., 194 Mich. 656, 161 N. W. 940)

8. The Reserve Loan Life Insurance Company issued a policy of insurance to Millard Filmore Sumner on his own life. The policy provided for payment of a cash surrender value to the insured upon receipt of a written request therefor. In an action brought by Sumner against the insurer, the court instructed the members of the jury that if they found that Sumner had sent to the insurer a request by mail, properly addressed, sealed, and stamped, Sumner was entitled to the surrender value of the policy. Was the instruction of the court correct? (Reserve Loan Life Ins. Co. v. Sumner, 70 Ind. A. 472, 123 N. E. 443)

9. The Great Eastern Casualty Company issued to Amelia Solinsky a policy of insurance against loss to an automobile caused solely by collision with another object, either moving or stationary. While driving on the Nolenville Pike at a rate of thirty to thirty-five miles an hour,

the insured, responding to what was thought to be a signal light at a railroad crossing, suddenly applied the brakes. The machine skidded, swerved, and reversed position, during which time the right rear wheel collapsed. Mrs. Solinsky brought an action against the insurer to recover on the policy. Was she entitled to judgment? (Great Eastern Casualty Co. v. Solinsky, 150 Tenn. 206, 263 S. W. 71)

10. Amelia Delouche by fraud was induced by an agent of the Metropolitan Life Insurance Company to take out a policy of insurance on the life of her husband, Edward Delouche. A bylaw of the company made the policy void. When Mrs. Delouche learned of the fraud, she demanded the return of the premiums that she had paid. Thereafter she brought an action against the company to recover the amount of the premiums. Was she entitled to judgment? (Delouche v. Metropolitan Life Ins. Co., 69 N. H. 587, 45 A. 414)

11. The American Monitor, a fraternal association, proposed to issue certificates of insurance, each for $250, payable in one hundred months or at the death of the holders of such certificates. An action was brought by George L. Walker to compel Theron F. Giddings, insurance commissioner, to authorize the association to do business in the state of Michigan. The case turned on the kind of insurance involved. How should the contract of insurance be classified? (Walker v. Giddings, 103 Mich. 344, 61 N. W. 512)

12. Mrs. Esther C. Curtiss loaned a sum of money amounting to over $6,000 to Alfred W. Tucker. Thereafter, she took out a policy of insurance for $10,000 on the life of Tucker. The assignee of the policy, Gilbert L. Curtiss, after the death of Tucker brought an action against the Aetna Life Insurance Company to recover on the policy. It was contended that the policy was not binding because Mrs. Curtiss did not have an insurable interest. Do you agree? (Curtiss v. Aetna Life Ins. Co., 90 Calif. 245, 27 P. 211)

13. The Penn Mutual Life Insurance Company of Philadelphia issued a policy of insurance to Rawles on his own life, with his wife, Edna M. Rawles, named as beneficiary. The policy contained a provision reserving to the insured the right to change the beneficiary. In an action brought by Mrs. Rawles against the insurer to recover on the policy, it was contended that Rawles had no right to assign the policy without the consent of Mrs. Rawles. Was this contention sound? (Rawles v. Penn Mut. Ins. Co., 253 F. 725)

14. A fire destroyed many buildings in the city of Baltimore, Maryland. Thereafter Katharine T. O'Brien brought an action against the Palatine Insurance Company, Limited, of Manchester, England, to recover on a policy against loss by fire. It was contended that the contract of fire insurance was an indemnity contract. Do you agree with this contention? (Palatine Ins. Co. v. O'Brien, 107 Md. 341, 68 A. 484)

15. The Columbia Fire Insurance Company issued a policy insuring all cotton presses of the American Cotton Company. In an action brought by Myron E. Evans, to whom the claim of the cotton company had been assigned, the insurance company sought to avoid the policy on the ground of false representation. The insurer contended that the intent of the insured to make a false representation did not affect its right to avoid the policy. Do you agree? (Evans v. Columbia Fire Ins. Co., 40 Misc. Rep. 316, 81 N. Y. S. 933)

16. The United States Fidelity & Guaranty Company issued to S. B. Roberts a policy of insurance against loss arising or resulting from claims upon the insured for damages in consequence of the ownership, the maintenance, or the use of an automobile. One day while driving his car, Roberts was accompanied by his wife, Mrs. R. S. Ramsey, and McKinley Pritchard. The car collided with another machine. Mrs. Roberts sued and recovered a judgment against her husband for the sum of $2,500. The insurer refused to pay the amount of the judgment, and Roberts brought an action to recover on the policy. Was he entitled to judgment? (Roberts v. United States Fidelity & Guaranty Co., 188 N. C. 795, 125 S. E. 611)

17. Edward H. Foley and John Costello owned a tract of land upon which three wooden houses were being built by a contractor. They became owners of the uncompleted buildings when the buildings were attached to the land, but they were not required to pay the contractor for the materials or the labor until ten days after the completion of the buildings. A policy of insurance against loss arising out of the destruction of the buildings by fire was taken out by Foley and Costello. In an action brought to recover on the policy, the insurer contended that Foley and Costello did not have an insurable interest in the buildings. Do you agree? (Foley v. Farragut Fire Ins. Co., 71 Hun 369, 24 N. Y. S. 1131)

18. John M. Stacey took out a policy of insurance on his own life for $1,000, payable to his wife, Pearl D. Stacey. The policy contained a provision whereby the insured reserved the right to change the beneficiary. A year later Stacey made J. R. Skinner and J. D. Wrather beneficiaries of the policy. After the death of Stacey, the proceeds of the policy were collected by Wrather and Skinner. Thereafter Mrs. Stacey brought an action against Wrather and Skinner, contending that she was entitled to the proceeds of the policy. Do you agree? (Wrather v. Stacey, 26 Ky. L. 683, 82 S. W. 420)

19. The Travelers' Insurance Company of Hartford, Connecticut, issued a policy of insurance to Constance A. Remley on his own life, payable to his executors, administrators, and assigns. A statute of Minnesota exempted from the claims of creditors policies of insurance effected by the insured in favor of another, or made payable to his wife or for her benefit. In an action brought by Nellie Remley against the insurance company and others, it was contended that the proceeds of

the foregoing policy were subject to the claims of creditors. Was this contention sound? (Remley v. Travelers' Ins. Co., 108 Minn. 31, 121 N. W. 230)

20. The Phoenix Fire Insurance Company issued an insurance policy to B. D. Ulman, a contractor, against "all direct loss or damages by fire, to an amount not to exceed $450, to a one-story shingle-roof building in Jamison, South Carolina." The building was totally destroyed by fire. Ulmer brought an action against the insurer to recover on the policy. It was contended that the policy issued to Ulmer was known as an open policy. Do you agree? (Ulmer v. Phoenix Fire Ins. Co., 61 S. C. 459, 39 S. E. 712)

21. The Capital Insurance Company, of Des Moines, Iowa, issued a policy of fire insurance to Pennypacker. The policy required that notice of loss be given to the insurer forthwith. The insured did not give immediate notice, but he did give notice of a loss within a reasonable time. In an action brought by Pennypacker against the insurance company, the company defended on the ground that notice of loss had not been properly given. Was Pennypacker entitled to judgment? (Pennypacker v. Capital Ins. Co., 80 Iowa 56, 45 N. W. 408)

22. The Virginia Fire & Marine Insurance Company issued a policy of fire insurance to Samuel Morgan. The policy was for the sum of $1,500 on a stock of goods in a storehouse at Cedar Bluff, Virginia. In an action brought by Morgan on the policy, the insurance company sought to avoid liability on the ground of breach of warranty. Morgan contended that the warranty was not material to the risk. Did Morgan's contention affect the defense of the insurer? (Virginia Fire & Marine Ins. Co. v. Morgan, 90 Va. 290, 18 S. E. 191)

23. Waring S. Weed and others, partners engaged in business under the name of W. S. Weed & Company, entered into a contract, whereby they insured J. K. Cuming against loss arising out of damage to a building by fire. A statute at that time made it unlawful for any person or association of persons, unless incorporated with express charter powers, to issue a policy of insurance, and it declared that any policy issued by such person or association shall be void. A loss occurred, and Cuming brought an action against the members of the firm to recover on a contract of insurance. Was he entitled to judgment? (Weed v. Cuming, 198 Pa. 442, 48 A. 409)

24. The Endowment Rank, Knights of Pythias, a beneficial organization, issued a policy of insurance for $3,000 on the life of A. M. Musson. The insurer was exempt from liability in case the death of the insured was due to the use of narcotics. After the death of Musson, an action was brought by Kate F. Allen against the insurer to recover on the policy. The insurer alleged that death was due to the use of narcotics. The plaintiff alleged in return that the drugs had been used under the advice of a physician. If both allegations were true, was the insurer liable? (Endowment Rank, Knights of Pythias v. Allen, 104 Tenn. 623, 58 S. W. 241)

25. The Home Insurance Company of New York issued to M. T. McGraw a policy of insurance against the loss by fire to the equipment of a laundry, including a steam boiler. By reason of the negligence of some person connected with the business, a fire was left burning all night beneath the boiler, which was empty of water. Because of the excessive heat the boiler was ruined. Thereafter McGraw brought an action against the insurer to recover on the policy. Was he entitled to judgment? (McGraw v. Home Ins. Co., 93 Kans. 482, 144 P. 821)

26. Lucien Farmer applied for a policy of insurance on his own life with the Mutual Reserve Fund Life Insurance Company. In his application he left one question unanswered. The company accepted the application and issued a policy. After the death of Farmer, Florence M. Farmer brought an action against the company to recover on the policy. It was contended by the insurer that the policy was not binding because of concealment. Do you agree with this contention? (Mutual Reserve Fund Life Ins. Co. v. Farmer, 65 Ark. 581, 47 S. W. 850)

27. Charles C. Davis, in return for a consideration, was given a certificate of membership in the Greenfield Mutual Burial Association, of Greenfield, Indiana. The object of the association was to furnish each of its members at death a specific sum of money for application to his funeral expenses, by a system of mutual contribution. In an action brought by the state against Matt Willett, representative of the association who dealt with Davis, it was contended that the association was engaged in the insurance business. Do you agree? (State v. Willett, 171 Ind. 296, 86 N. E. 68)

28. The holder of a liability policy had an accident, injuring his brother. He, his brother, father, mother, and sister all lived together. The insurer contended that it had no liability under a clause exempting liability for "accidents to members of the assured's household, including domestic or household servants." Was this contention sound? (Cartier v. Cartier, 84 N. H. 526, 153 A. 6)

29. Albert Kubel, a member of a school basketball team, transported other team members in his automobile on a trip. Under an agreement he was compensated for the cost of the oil and gasoline and given in addition a small amount for the use of his car. An accident occurred, injuring several persons in the automobile. The insurer contended it had no liability under a clause exempting liability for injuries sustained while the insured was "carrying passengers for hire." Do you agree? (Gross v. Kubel, 315 Pa. 396, 172 A. 649)

30. Pat Cooper, accompanied by several persons, was driving his car to Detroit to purchase a new car. During this time an accident occurred, injuring two persons in the car. Though not pursuant to any agreement, some of the persons in the car had paid for the gasoline consumed on the trip. The insurer contended that the accident occurred while Cooper was "carrying passengers for hire." Do you agree? (Indemnity Ins. Co. v. Lee, 232 Ky. 556, 24 S. W. [2d] 278)

CHAPTER VII
BAILOR AND BAILEE

Part I—General Considerations

Introduction. A very common relation is the *bailment* relation. There are none so poor nor so rich that they do not with greater or less frequency utilize this relation, and many utilize it many times daily. Though general in its utilization, the relation is most significant in the field of marketing. One engaged in selling and distributing products should especially be familiar with the principles governing the rights and liabilities involved in a bailment. The most modest attempt at distribution of goods requires some form of transportation and storage, both of which involve the bailment relation.

As this relationship has been utilized since the early days of civilization, the principles governing it, as would be expected, are of ancient origin. The civil or Roman law developed well-defined rules as to the relation, and many civil law terms crept into the common law. The term *bailment* comes, however, from *bailler*, a Norman word meaning "to deliver." The origin of the law of bailments, as it stands today, dates from about the beginning of the eighteenth century, although the principles were not fully worked out until about the beginning of the nineteenth century.

Definition. A *bailment* is defined as a relation under which one party has possession of personal property of another for a specific purpose, with the obligation to dispose of it afterwards as directed by the latter. The party who turns over the property is the *bailor*, and the one who holds the goods is the *bailee*.

The relation is sometimes said to exist when there is "a delivery of some personal property, the subject of larceny, by one person to another, to be held, according to the purpose or object of the delivery, and to be returned or delivered over

when that purpose is accomplished." [1] In order that the definitions be clarified, some aspects of the relation may be mentioned here.

First, the relation ordinarily arises out of an express or implied agreement. In some situations, however, courts will impose upon a person the obligation of bailee regardless of his assent. For example, an officer arrests an alleged thief and is given the goods which his prisoner had thrown aside during the pursuit. The officer is a bailee of the property.[2]

> "A constructive bailment arises where the person having possession of a chattel holds it under such circumstances that the law imposes upon him the obligation of delivering it to another." (Hope v. Costello, 222 Mo. A. 187, 297 S. W. 100)

Second, the subject of bailment may be any kind of personal property of which possession may be given. Real property, however, cannot become the subject of bailment. Thus, when one by lease transfers possession of his farm to another for a period of ten years, the relation of bailment is not created unless personal property is also involved.[3]

> "The general rules of bailment apply to aircraft, just as they do to motorcars and horses." (Whitehead v. Johnson, 150 Misc. 86, 268 N. Y. S. 368)

Third, anyone in possession of personal property may become a bailor. He may possibly be in unlawful possession of it. It is sufficient if he has a right to retain the goods against all but the true owner. A thief, for example, may be a bailor.[4]

Fourth, the property bailed usually must be delivered and accepted. The delivery may be actual, as when a book is lent to someone, or constructive, as when a large machine is pointed out to the bailee who takes control of it. In a few instances one may be held as a bailee without delivery being made. Thus courts impose upon a finder of property the obligations of a bailee.[5] In such cases acceptance may be implied from the voluntary act of taking possession of the goods.

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[1] *State* v. *Seeney*, 21 Del. 142, 59 A. 48.
[2] *Burns* v. *State*, 145 Wis. 373, 128 N. W. 987.
[3] *Dewey* v. *Bowman*, 8 Calif. 145.
[4] *Caldwell* v. *Eaton*, 5 Mass. 399.
[5] *Dougherty* v. *Prosegate*, 3 Iowa 88.

Classification. Bailments are classified as ordinary and extraordinary. The latter group includes bailments in which the bailee is given unusual duties and liabilities, as in the case of the innkeeper or the common carrier. The first group includes all other bailments. Bailments may be with or without recompense to the bailee. Upon that basis they are sometimes classified as bailments for hire and gratuitous bailments. It is more convenient, however, to classify bailments in terms of the benefit derived from the relation. This classification is as follows.

Sole Benefit of the Bailor. When goods are delivered to another who is to keep them or to perform some service in respect thereto without compensation, the relation is a bailment for the sole benefit of the bailor. For example, a bailment of this type exists when one gratuitously carries another's hay to the city.[6]

Sole Benefit of the Bailee. When goods are delivered to another for use without compensation, the relation is a bailment for the sole benefit of the bailee. Thus, when a person borrows the automobile of a friend, there is a bailment for the sole benefit of the bailee.[7]

Mutual Benefit of Both Parties. When goods are delivered to another under a contract of hiring, the relation is a bailment for the mutual benefit of both parties. For example, if one delivers his rugs to another under an agreement by which he hires the latter to clean them, a mutual-benefit bailment is created.[8]

The Contract of Bailment. As previously indicated, the relation of bailment may be imposed upon one by law. Such bailments are sometimes classed as *involuntary* bailments. They are established when, by unavoidable accident or casualty, the goods are left upon another's land. For example, lumber may be washed upon another's land and left there, or

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[6] *Goodenow* v. *Snyder*, 3 Greene (Iowa) 599.
[7] *Bennett* v. *O'Brien*, 37 Ill. 250.
[8] *Bowen* v. *Isenberg*, 22 Del. 230, 67 A. 152.

articles may be blown there by a strong wind. In such cases the owner of the land becomes bailee of the property.[9]

> A merchant who refused goods, but accepted them to prevent the sale thereof for freight, was held to be in "the position of an involuntary gratuitous bailee." (Curlee Clothing Co. v. Robinson, 130 Okla. 104, 265 P. 108)

In most cases, however, bailments are created by agreement, express or implied. For example, when one finds lost goods and takes possession thereof, if he holds them as a bailee at all, he holds them as bailee for the owner under an implied contract of bailment.[10] In such cases the bailee voluntarily assumes possession and control of the property as a bailee. The usual principles of the law governing contracts are applicable to bailments originating in express agreements.

> An ambiguous bailment contract "must be construed most strongly against the party who prepared it." (Wells v. Thomas W. Garland, Inc. [Mo. A.], 39 S. W. [2d] 409)

Generally speaking, the contract creating the relation is not required to be in writing. In some states, however, a statute may require the contract to be in writing for the protection of third persons against fraud. By way of illustration, a statute may provide that creditors of the bailee may levy on the property which has been in his possession for a period of five years, unless the title of the bailor appears of record.[11]

Right of Property and Possession. In a bailment the right of possession, but not the right of general property, passes to the bailee. An essential element of bailment is the bailee's duty to return the same goods, although possibly in an altered form, or to deliver them to a third person in accordance with the expressed or implied intention of the bailor. If the agreement provides that the party to whom the goods are delivered shall return other goods or pay the value of the delivered goods in money, it is an exchange or a sale. For example, if

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[9] *Walker* v. *Norfolk, etc., Ry. Co.*, 67 W. Va. 273, 67 S. E. 722.
[10] *Phelps* v. *People*, 72 N. Y. 334.
[11] *Scott* v. *Jones*, 76 Va. 233.

a person allows another to take his horse under an agreement to return a different one, the transaction is a barter.[12]

> "The contract of bailment does not contemplate any change in the legal title to the property bailed—it remains in the bailor." (Harris v. Seaboard Air Line Ry. Co., 190 N. C. 480, 130 S. E. 319)

The essential difference between a bailment and a sale, a gift, or a barter is that in the latter transactions the right of general property is involved. In a bailment, on the other hand, the right of general property or ownership remains in the bailor or in the owner. This right is superior to the claims of creditors of the bailee, or of parties to an unauthorized sale, unless the bailor is by his conduct estopped to set up his ownership. Thus, if the bailor by his statements leads another reasonably to believe that the bailee is the owner of the articles, the bailor is estopped from asserting his right if the latter changes his position in reliance on the statements.[13]

> A physician allowed another to use his automobile for a certain purpose. The bailee purported to sell the car to one Allen. It was held that the bailor was not estopped to assert his ownership. (Owen v. Allen, 169 Okla. 351, 36 P. [2d] 277)

A qualified right of property, however, passes to the bailee. It is a possessory right which can be asserted against all but the bailor. It may even be asserted against him, with exceptions to be noted later. The bailee cannot, as a general rule, question the title of the bailor. Thus, when a person finds property and deposits it with another, the latter cannot keep the property on the ground that the bailor is not the owner.[14]

> "Where a bailee has the right of possession of the property bailed for a definite time and for his beneficial use, his right, until the time has expired, is paramount to any right of the bailor." (Noel v. Cowan, 80 Mont. 258, 260 P. 116)

If the bailee manifests an intention to hold the property adversely to the bailor, and holds it during the period set forth by the Statute of Limitations, the bailor loses his title. The

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[12] *King* v. *Fuller*, 3 Cal. (N. Y.) 152.
[13] *McMahon* v. *Sloan*, 12 Pa. 229.
[14] *Tancil* v. *Seaton*, 67 Va. 601.

Statute of Limitations, however, does not begin to run against the bailor's right until the bailor receives notice of the adverse claim. Any unequivocal act manifesting such intention is a sufficient adverse claim. For example, an attempt by the bailee to sell the subject matter of the relation, if it comes to the bailor's attention, constitutes an adverse claim.[15]

Termination of Bailments. The relation of bailment may be terminated in one of several ways: by agreement, by act of the bailee, by incompetency of the parties, or by destruction of the subject matter.

Agreement. As in the case of other contracts, the parties to a bailment may bring the relation to an end by mutual agreement. The original contract of bailment may provide that either party may rescind upon the happening of a certain event or at will. To illustrate, the agreement may stipulate that the bailee may terminate the bailment if the goods do not meet with his approval.[16] Another form of termination by agreement exists when the parties set a time in the original contract during which the bailment relation is to exist. For example, one may agree to care for certain goods belonging to another for one week only. His responsibility as bailee ceases at the end of that period.[17]

> In the absence of agreement as to length of time during which a bailment of garments is to continue, "it may be terminated by the depositor at any time." (Wolfe v. Willard H. George, Inc., 110 Calif. A. 532, 294 P. 436)

The relation also comes to an end with the accomplishment of the object or purpose of the bailment. For example, when a farmer hires certain machinery for harvesting his crops, the bailment ends upon completion of the task in question.[18] This is merely another form of termination by agreement, similar to termination by expiration by lapse of agreed time, except that in this case the time of termination is indefinite.

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[15] *Echols* v. *Barrett*, 6 Ga. 443.
[16] *Lance* v. *Griner*, 53 Pa. 204.
[17] *Barr* v. *Van Duyn*, 45 Iowa 228.
[18] *Chattahoochee Nat'l Bank* v. *Schley*, 58 Ga. 369.

Act of Bailee. The bailment may be terminated by any act of the bailee which will jeopardize the bailor's right to the goods. Thus, if the bailee sells the goods to a third person, the relation ends.[19] The bailor is also entitled to terminate the relation upon the bailee's failure to perform any of the conditions contained in the bailment contract.

Incompetency of Parties. The bailment may be terminated upon the event of the bankruptcy or insanity of one of the parties. If such a circumstance renders it impossible for the bailor or bailee to perform his obligations, the other party is entitled to bring the relation to an end. In some situations the death of one party will terminate the relation. By way of illustration, the bailment is terminated upon the death of the bailee when the bailment is for his sole benefit.[20]

Destruction of Subject Matter. The bailment is terminated if the goods bailed become lost or totally or partially destroyed. The same rule is applied when the articles become unfit and unsuitable for the purpose of the bailment. Although misuse alone does not end the relation, the effect of misuse may bring about that result. For example, when, as a result of the bailee's negligence, the subject matter becomes unsuitable for the purpose or object of the bailment, the contract of bailment is terminated.[21]

QUESTIONS

1. "Though general in its utilization, the relation of bailment is most significant in the field of marketing." What is meant by this statement?

2. Troy, upon learning that he is out of feed for his stock, borrows ten bales of hay from Hichens. He agrees to return an equal amount of hay within three days. Has the relation of bailment been established between Troy and Hichens?

3. Mullins, who owns a farm of one hundred and sixty acres, leases the property to Catton. After the latter has taken possession, the former contends that Catton is bailee of the property. Do you agree?

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[19] *Bailey* v. *Colby*, 34 N. H. 29.
[20] *Smiley* v. *Allen*, 13 Allen (Mass.), 465.
[21] *N. Y., etc., Ry. Co.* v. *N. J. Electric Ry. Co.*, 60 N. J. L. 338, 38 A. 828.

4. Lockhart steals a hatbox from a passenger in a railway station. He takes the hatbox to a checkroom in one of the large stores of the city and deposits it there. The hatbox disappears and cannot be found when Lockhart calls for it. Lockhart contends that he is entitled to the rights of a bailor. Do you agree?

5. Willis, while hurrying to a suburban train station, loses a package containing a valuable jewel. Lupton, who happens to pass that way shortly thereafter, picks up the package and places it in his pocket. When Lupton arrives home, he opens the package and discovers the nature of its contents. Thereafter, Willis brings an action to hold Lupton upon a liability as a bailee of the goods. Was Lupton a bailee of the jewel?

6. Wheeler tells Mrs. Jones that he will clean her curtains without charge if she will allow him to do it during the winter months. In January she tells him that she desires to accept his offer. Wheeler calls for and receives the curtains which he takes to his place of business. Classify this bailment in terms of the benefit derived from the relation.

7. An unprecedented rainfall flooded the land bordering the Mississippi River. When the water had subsided, several pieces of furniture belonging to Alger were left upon the land of a neighbor. Thereafter Alger brought an action against his neighbor upon the theory that the neighbor had become a bailee of the furniture. Was Alger's theory correct?

8. York borrows Kantor's truck to remove the trash that has accumulated in his back yard. After completing his task, York sells the machine to MacKinley. Kantor brings an action against MacKinley to recover possession of the truck. Is he entitled to judgment?

9. While going to his place of work, Keith finds a diamond ring in the street. Fearing that he might lose it during the day, he requests his employer to keep the ring in his safe. Just before the office is closed, Keith returns for the ring. The employer, having learned that the ring does not belong to Keith, refuses to return it. Keith brings an action against his employer to recover possession of the ring. Is he entitled to judgment?

10. Murray borrows an ax and a saw from Engle for the purpose of felling a tree. Murray fells the tree and returns the tools to Engle. Thereafter the saw disappears. Engle brings an action against Murray, contending that Murray is liable as bailee for the loss of the tool. Is he entitled to judgment?

Part II—Ordinary Bailments

Duties and Liabilities of the Bailee. The relation of bailment is characterized by certain duties and liabilities imposed by law. These duties and liabilities may, however, be increased or modified by express contract. "By such agreement the bailee may be relieved of all liability except for his fraud or negligence, or he may become an insurer and, as such, absolutely liable for any loss, injury, or damage to the property." [1] Unless they are changed by agreement or statute, the bailee is under the following duties and liabilities.

Performance. The bailee must perform his part of the contract and is liable to the bailor for failure to do so. He is also liable for any loss arising out of his failure to act in accordance with the terms of the agreement. For example, in a case in which the bailee was required to ship goods to one city but sent them to another, he was held liable for their loss en route.[2]

> "When work and labor are to be performed upon the property delivered to the bailee, one of the implied obligations of the contract is that the bailee shall exercise ordinary care and skill adequate to the proper performance of the work." (Devinne Hallenback Co. v. Autotyre Co., 113 Conn. 97, 154 A. 170)

Redelivery. The bailee, as a general rule, is under a duty to return the specific subject matter of the bailment or to dispose of it as directed. This obligation, implied by law in the absence of express stipulation, arises out of the nature of the relation. The redelivery or delivery must be made in accordance with the terms of the contract as to time, place, and manner. When the agreement does not control these matters, the customs and usages of the community govern.

> A parking lot owner was held to the duty to see that automobiles were not removed, except upon surrender of the tickets issued to the bailors. (General Exchange Ins. Corp. v. Service Parking Grounds, 254 Mich. 1, 235 N. W. 898)

The bailee is excused from redelivery or delivery when the goods are lost, stolen, or destroyed without his fault. To

[1] *Direct Nav. Co.* v. *Davidson*, 32 Tex. Civ. A. 493, 74 S. W. 790.
[2] *Ferguson* v. *Porter*, 3 Fla. 27.

illustrate, certain goods are destroyed by a flood while in possession of the bailee. If the loss is not due to his negligence, the bailee is excused from the duty to redeliver, and the bailor must suffer the loss.[3] The bailee is also excused from this duty when the goods have been taken from him under process of law in connection with proceedings against the bailor. If the bailee has a lien on the subject matter, he is, of course, under no duty to redeliver the property until he has received payment in discharge of the lien.

Unauthorized Use. The bailee is liable in tort for conversion if he uses the property without authority. When he has the authority, he is liable if he uses the property in any other way than that to which the bailor assented. To illustrate, a person borrows a horse from another to use as a saddle horse, but he uses it to plow his fields. This unauthorized use of the property is conversion.[4]

> When the purpose for which an automobile was lent by the bailor was exceeded by the bailee, "a conversion immediately occurred." (Burnett v. Edw. J. Dunnigan, Inc., 165 Wash. 164, 4 P. [2d] 829)

Care of the Property. In ordinary bailments the bailee is under a duty to use *reasonable* care in the protection of the property entrusted to him. What constitutes reasonable care depends upon the type of the bailment and the nature of the subject matter. In some types of bailments one may reasonably expect the bailee to use greater diligence than in others. Hence the duty of care which is imposed upon the bailee is often roughly classified into three degrees. In a bailment for the sole benefit of the bailee, *great* care is required of the bailee; in a mutual-benefit bailment, *ordinary* care; and in a bailment for the benefit of the bailor, only *slight* care.

> An ordinary bailee "never becomes an insurer of the articles intrusted to him, except under the terms of a special contract creating such an obligation." (Barnett v. Latonia Jockey Club, 249 Ky. 285, 60 S. W. [2d] 622)

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[3] *Link* v. *Hathway*, 143 Mo. A. 502, 127 S. W. 913.
[4] *Raynor* v. *Sheffler*, 79 N. J. L. 340, 75 A. 748.

In all cases, however, the standard required is really that of reasonable care under the circumstances. The nature of the goods, as well as the type of bailment, is a factor to be taken into consideration in determining what constitutes reasonable care. To illustrate, one person is the paid bailee of a jewel and another is the paid bailee of an anvil. The degree of care to be exercised in each case is said to be ordinary, but it is quite obvious that ordinary care of a jewel is different from ordinary care of an anvil.[5] The time and the place of the bailment likewise are factors to be taken into consideration in determining the requisite care. To illustrate, reasonable care in protecting property in the rural districts may not be reasonable care in protecting property in a city.[6]

In connection with the liability of the bailee, the early decisions, as well as the early writers on bailments, employed three degrees of negligence—*gross*, *ordinary*, and *slight*. This theory, borrowed from the Roman law, has been criticized by many courts and repudiated by others. Justice Bradley of the Supreme Court, referring to the liability of the bailee, declared: "If very little care is due from him, and he fails to bestow that little, it is called gross negligence. If very great care is due, and he fails to come up to the mark required, it is called slight negligence. And if ordinary care is due, such as a prudent man would exercise in his own affairs, failure to bestow that amount of care is called ordinary negligence. In each case the negligence, whatever epithet we give it, is failure to bestow the care and skill which the situation demands; hence it is perhaps more strictly accurate to call it simply 'negligence,' and this seems to be the tendency of the modern authorities." [7]

Rights of the Bailee. The rights of the bailee, as his duties and liabilities, may be modified or enlarged by the terms of the contract of bailment. When the contract does not control, the rights of the bailee are, generally speaking, those described in the following paragraphs.

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[5] *Chase* v. *Maberry*, 3 Del. 266.
[6] *Siegal* v. *Eisner*, 138 N. Y. S. 174.
[7] *N. Y. Cent. R. R. Co.* v. *Lockwood*, 17 Wall. (U. S.) 357, 21 L. Ed. 627.

Use of the Property. In a bailment for the sole benefit of the bailee, the right of the bailee to use the property is strictly limited to the use contemplated by the bailor when assenting to the relation. For example, if a person borrows a horse to use in a certain city, he cannot use it in another.[8] When the bailment is for the sole benefit of the bailor, the bailee may not use the property except in so far as its use may be necessary in keeping it in good condition. A situation in which use is necessary exists in the case of certain animals, such as a race horse. In this case, however, the bailee could not use the horse for his own purposes. In a mutual-benefit bailment the bailee, generally speaking, has the right to use the property in accordance with the terms of the contract. When this type of bailment is for storage only, right to use does not exist, unless some use is necessary to preserve the property. Thus a bailee who is merely a custodian of an automobile has no right to use it or to allow another to use it without permission from the bailor.[9]

> A pilot who rented an airplane had no right to use it contrary to the instructions of the bailor. (Whitehead v. Johnson, 150 Misc. 86, 268 N. Y. S. 368)

In all types of bailments the extent of the right of use is a question of intention. "The authorities seem to agree that the right of the bailee to use the property, in the absence of express contract on the subject, depends on the circumstances of the case, the character and purpose of the bailment, and the nature of the property in connection with the other attending circumstances." [10]

Right to Insure. The bailee has an insurable interest in the goods bailed and may take out insurance thereon.[11] In some instances he is required by custom or by agreement to insure the property.

Compensation. Whether the bailee is entitled to compensation for his services depends upon the contract of bailment.

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[8] *Lane* v. *Cameron*, 38 Wis. 603.
[9] *Geren* v. *Hollenbock*, 66 Oreg. 104, 132 P. 1164.
[10] *Alvord* v. *Davenport*, 43 Vt. 32.
[11] *Ante*, p. 402.

In the absence of agreement to the contrary, courts assume that the bailor intended to pay the reasonable value for services rendered, unless the circumstances clearly preclude such inference. The bailee is not entitled to compensation in a bailment for the sole benefit of the bailee. The same rule applies when the bailment is for the sole benefit of the bailor. Thus, if a bailee holds goods gratuitously, he is not entitled to charge for his services until after giving notice of his unwillingness to continue under the present arrangement.[12] In a mutual-benefit bailment the bailee is ordinarily entitled to compensation only when he has fully performed according to the terms of the contract. In cases where the bailee is to perform services upon goods furnished by the bailor, and the goods are lost, stolen, or destroyed without fault of the bailee, the latter is usually entitled to recompense for the work done. Custom, usage, or the terms of the contract may, however, place the loss on the bailee. For example, if the bailee is to perform services on goods under an agreement which provides for payment "only after delivery in good order to our store," he assumes the risk of loss.[13]

> A bailee, negligently employing a messenger to return goods to the bailor, could not recover for work on the goods which were stolen by the messengers. (F. & L. Mfg. Co. v. Jomark, Inc., 134 Misc. Rep. 349, 235 N. Y. S. 551)

Lien. In ordinary bailments for hire the common law creates a specific lien on the goods in favor of a bailee who performed services which enhanced the value of the articles. Other bailees in this class are not entitled to a lien. By way of illustration, one who acts merely as custodian is given no right of lien on the goods,[14] but the parties may in their contract provide for a lien. At the present time statutes in many states have to a considerable extent changed the common law in regard to liens of bailees. For example, in some instances a bailee has a right of lien even though his services do not bestow value upon the subject matter of the bailment.[15]

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[12] *G. A. Crancer Co.* v. *Combs*, 95 Nebr. 403, 145 N. W. 863.
[13] *Stern* v. *Rosenthal*, 56 Misc. Rep. 643, 107 N. Y. S. 772.
[14] *Lewis* v. *Gray*, 109 Me. 128, 83 A. 1.
[15] *Lambert* v. *Davis*, 116 Calif. 292, 48 P. 123.

Statutory mechanic's lien supplements, but does not supplant, the common-law lien of bailee who performs services on goods bailed. (Howell v. Dodd, 229 Ala. 393, 157 S. 211)

Action against Third Persons. The bailee has a qualified property or possessory right in the goods bailed. This right of possession entitles him to bring action against third persons for interference with his possession or for any injury to the goods. When the bailment is one that the bailor may terminate at will, the bailee is, however, divested of his right of action against third persons if the bailor has already brought action on the same facts. To illustrate, if one person converts saw logs and piling that another holds for the owner, and the owner intervenes and asserts his rights against the wrongdoer, the bailee, in the absence of a special interest, cannot bring action against the converter.[16]

Duties and Liabilities of the Bailor. The duties and liabilities of the bailor are coextensive with the terms of the contract of bailment, the provisions of which may decrease or enlarge the duties and liabilities ordinarily imposed by law. In the absence of express stipulations, the following duties and liabilities are generally imposed on the bailor.

Condition of the Property. In a mutual-benefit bailment, as when the bailee hires the use of certain property, the bailor is under a duty to furnish goods reasonably fit for the purposes contemplated by the parties. To illustrate, if a person hires the use of certain machinery from another, and if he suffers an injury as a result of the improper condition of the thing bailed, the bailor is liable.[17] If the bailment is for the sole benefit of the bailee, the bailor is only under a duty to inform the bailee of defects of which he is actually aware.

Repairs to Goods. The bailor under a hiring contract has no duty to make repairs which are ordinary and incidental to the use of the goods bailed. The bailee must bear the expense of such repairs. If, however, the repairs required are of an unusual nature, a different rule is applied. "The author-

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[16] *Engel* v. *Scott, etc., Lumber Co.*, 60 Minn. 39, 61 N. W. 825.
[17] *Williamson* v. *Phillipoff*, 66 Fla. 549, 64 S. 269.

ities, so far as they speak upon this question, are in substantial accord in support of the rule that, at common law, in the absence of an express contract, the bailor is responsible for extraordinary repairs which inure to his benefit and which were not caused through the neglect or fault of the bailee; and that the bailee should bear the expenses ordinary and incidental to the thing bailed." [18]

> One renting a portable compressor is under a duty as bailee to bear the expense of those repairs which are ordinary and incidental to the use of the machine. (Schmidt-Hitchcock Contractors v. Dunning, 38 Ariz. 360, 300 P. 183)

Reimbursement. The bailor is under a duty to reimburse the bailee for actual disbursements under circumstances in which the expense should be borne by the former. For example, if the bailee is forced to defend an action at law brought by a party claiming the goods, he is entitled to reimbursement for expenses incurred in the litigation.[19] If the expense, however, is incurred by reason of the bailee's negligence, misconduct, or misuse of the property, the bailor is under no duty to reimburse him.

Performance of Contract. The bailor is, of course, under a duty to perform his part of the agreement. If he violates any of the provisions of the contract, he is answerable in damages. To illustrate, a person hires the use of another's automobile for a period of one month. If the bailor takes possession of the machine without cause at any time before the agreed time for the expiration of the bailment, he is guilty of a wrong against the bailee.[20]

Rights of the Bailor. The rights of the bailor, as his duties and liabilities, are determined by the terms of the contract. When an agreement does not control, the following principles of law are applicable in determining the rights of the bailor.

Rent. The bailor is entitled to the agreed compensation in a bailment of hire. Some courts hold that there exists an

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[18] *German-American Bank* v. *Normille*, 82 Wash. 368, 144 P. 289.
[19] *Bacon* v. *N. Y. City Fourth Nat'l Bank*, 9 N. Y. S. 435.
[20] *Simpson* v. *Wrenn*, 50 Ill. 222.

implied agreement for reasonable rent when the bailor allows another to use his property, and nothing is said as to compensation. Other courts deny such a right. The bailor loses his right to compensation if the bailment is terminated through his fault. If the bailee loses possession or use of the goods through no fault of his own, the bailor is entitled to rent only during the period of use, unless otherwise stipulated. For example, the bailee is not liable for rent while the property is being repaired.[21] The same rule is applied when the goods are stolen, destroyed, or retaken by the bailor through no fault of the bailee.

> The bailee of an electric sign, who was forced by a fire to move his business, was not liable for continued rent under a contract that did not permit him to use the sign elsewhere. (Claude Neon Federal Co. v. Meyer Bros. [La. A.], 150 S. 410)

Against Third Persons. In a bailment at will, the bailor has immediate right to possession and may maintain an action against third persons to recover damages or to recover possession of the goods. In a bailment for hire existing over a period of time, the bailor may bring an action to recover damages for any injury to his reversionary interest by a third party.

> One who wrongfully takes an automobile from a bailee, who has borrowed the machine, is liable to the bailor for conversion. (Post v. Lloyd, 13 N. J. Misc. 241, 177 A. 560)

Against the Bailee. The bailor may bring an action of assumpsit against the bailee for breach of contract if the goods are not redelivered. He may also maintain actions in tort, such as case for negligence, trespass for destruction of the property, detinue or replevin for unlawful retention of possession, or trover for conversion of the goods. The bailor for hire for a definite period of time cannot, however, maintain the action of trover for conversion because he does not have immediate right to possession, except when the act of the bailee terminates the bailment. Thus one court states that if the bailee "merely uses the property in a manner or for

[21] *Knickerbocker Trust Co.* v. *Ryan*, 227 Pa. 245, 75 A. 1073.

a purpose not authorized by the contract, and without destroying it, or intending to injure or impair the reversionary interest of the bailor therein, such misuse does not determine the bailment, and therefore is not a conversion for which trover will lie." [22]

QUESTIONS

1. Preller arrives by train at a small town with a trunk and two pieces of hand luggage. He hires Peterson who has his wagon near by to carry these articles to the Lost Gate Hotel. Peterson delivers the packages to the East Side Hotel, at which place the two pieces of hand luggage disappear. Preller brings an action against Peterson to recover damages. Is the latter liable for the loss?

2. McClure hires Drumfall to keep a piano during the months of June, July, and August. In July the piano is taken from Drumfall under a valid writ of execution to satisfy an unpaid judgment which Brooks had obtained previously against McClure. At the end of August McClure demands the piano from Drumfall. As the latter is unable to return it, McClure brings an action for damages against him for failure to redeliver the subject matter of the bailment. Is he entitled to judgment?

3. Olson at Byrne's request agreed to keep, free of charge, the latter's race horse while Byrne went away on a vacation. While Byrne was away, Olson entered the horse in a race at the county fair held in a neighboring city. When Byrne learned how Olson had used the animal, he brought an action for damages against him. Was he entitled to judgment?

4. Emmerson Weggeland hired the use of a tractor for the period of a harvest season. Notwithstanding the exercise of ordinary diligence on the part of Weggeland, the machine was seriously injured during the time it was in his possession. The owner of the tractor brought an action against Weggeland to recover damages for an alleged failure to exercise the proper care in respect to the bailed article. Was the owner entitled to judgment?

5. A farmer took a truckload of watermelons to the city. As the market had closed when he arrived, he drove to a garage and left his truck there for the night. The next morning the garage owner demanded storage charges. The farmer refused to pay on the ground that nothing had been said about compensation. The garage owner brought an action against the farmer to recover storage charges. Was he entitled to judgment?

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[22] *Harvey* v. *Epes*, 12 Gratt. (Va.) 153.

6. Clark delivers several chairs to Vogel, a cabinetmaker, who agrees to refinish them for twenty dollars. After the work is completed, the building is totally destroyed by fire without fault on the part of Vogel. The latter now demands the twenty dollars which Clark agreed to pay for the work. When the demand is refused, Vogel brings an action to recover the amount from Clark. Is he entitled to judgment?

7. O'Neill, who is going on a camping trip, delivers his watch to Gay, a jeweler, who agrees to keep it during this period in return for five dollars. When O'Neill comes back, he demands his watch without paying the agreed amount. Gay refuses to redeliver the article until O'Neill pays him the stipulated compensation. O'Neill brings an action against Gay to recover possession of the watch. Is he entitled to judgment?

8. DeFord borrows the use of Granady's row boat for a period of three days. The next day Gilchrist takes the boat from DeFord without his permission and refuses to return it until twenty-four hours later. Granady brings an action of trover against Gilchrist for converting the property. Is he entitled to judgment?

9. Eaton borrows the use of Maxwell's automobile to take his family on an outing. As the result of a defective steering wheel, the car runs into a ditch, causing an injury to Eaton. The latter brings an action for damages against Maxwell, contending that Maxwell is liable because the automobile was not reasonably fit for the purpose contemplated. Is his contention sound?

10. Spangler hires the use of Mathews' drafting instruments. One day Spangler negligently drops the small compass, breaking one of the adjusting screws and blunting the pivot point. After having the instrument repaired and paying the charges, Spangler demands reimbursement from Mathews. When the demand is refused, Spangler brings an action against Mathews to recover the amount of the repair charges. Is Spangler entitled to judgment?

Part III—Pledges

Nature of a Pledge. A pledge is a special form of mutual-benefit bailment whereby one person transfers possession of personal property to another to secure the payment of a debt or the performance of another obligation. The bailor, or one who gives up the goods, is in this transaction described as the *pledgor*; and the bailee, or one who receives the property, is described as the *pledgee*.

All transfers of possession of personal property as security are pledges. The transfer must, however, actually be made as security. To illustrate, a consignment of goods to a factor who is a creditor of the consignee does not create a pledge.[1]

A pledge is distinguished from other types of bailments by the nature of the lien possessed by the pledgee. The pledgee's right of lien differs from the right of lien given to a bailee in some of the ordinary bailments, in that the pledgee is entitled to sell the goods in the event of nonperformance of the obligation secured. The lien of the pledgee is similar in that it is dependent upon possession of the goods and may be waived by a voluntary surrender of the subject matter to the bailor or his agent. To illustrate, if the pledgee allows the pledgor to resume possession of the property, the right of lien is lost.[2]

Rights and Liabilities of the Parties. The rights and liabilities of the parties may be fixed by the provisions of the contract of pledge. When an express agreement does not control, the following rights and duties are generally enforced.

The pledgee is entitled to possession of the goods until the obligation has been performed, and he may maintain an action against any person interfering with his possession. Thus, if the pledgor wrongfully takes possession of the pledged articles, he is liable to the pledgee for conversion.[3] At common law the creditors of the pledgor cannot levy on the goods. Under the statutes of some states, however, the goods may be sold by the creditors subject to the pledgee's lien. The pledgee

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[1] *Rochester Bank* v. *Jones*, 4 N. Y. 497.
[2] *Thompson* v. *Dolliver*, 132 Mass. 103.
[3] *Walcott* v. *Keith*, 22 N. H. 196.

is entitled to reimbursement for necessary expenses arising out of the relation. For example, when storage is necessary in the care of property, the pledgee is entitled to make reasonable charges for such expense.[4]

> A pledgee is entitled to reimbursement for "the payment of taxes, assessments, and insurance premiums." (Gordon v. Mohawk Bond & Mortgage Co., 317 Pa. 257, 176 A. 422)

Although the pledgee cannot use the property without the assent of the pledgor, he may assign his interest in the goods or repledge them to a third person. He must not, however, dispose of them in such a way as to preclude immediate redelivery upon fulfillment of the obligation secured. For example, a person who, receiving stock in pledge, sells the property before default is liable for the value thereof.[5] When the subject matter of the pledge consists of an obligation of a third person, as a commercial paper, the pledgee may not sell it but must receive payment or collect on it when it matures. He must, however, account to the pledgor for all the income received from the property held in pledge. If the pledgee, without authority, modifies the obligation of the third party, as by extending or renewing a note, and thus injures the pledgor in any way, he is liable. To illustrate, a pledgee of a note made by a third person, without the consent of the pledgor, releases the maker from his obligation. He is liable to the extent of the loss suffered by the pledgor.[6]

Discharge of a Pledge. The pledgee is under a duty to return the property pledged (or the proceeds thereof, as in the case of a note paid at maturity) when the pledgor is discharged from the obligation for which the pledge was given. When the pledge is discharged, the pledgor is at once reinvested with complete ownership of the goods. If the pledgee fails to return the subject matter of the pledge, he is liable for conversion. The pledgor is required to demand the return of the property only when the pledgee has no means of knowing whether the pledgor is entitled to its return. Thus the

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[4] *British Columbia Bank* v. *Frese*, 116 Calif. 9, 47 P. 783.
[5] *Hardy* v. *Johnson*, 41 N. Y. 619.
[6] *Brown* v. *Newton First Nat'l Bank*, 112 F. 901.

return of the property must be demanded when the payment of the obligation secured is made to a third party.[7]

> " 'It is the duty of the debtor to seek the creditor at the proper place and pay the debt, or tender payment, before he is entitled to receive back the pledge.' " (Bardsley v. First Nat. Bank & Trust Co., 111 N. J. L. 512, 168 A. 665)

The usual method of discharge is by performance of the obligation. If the obligation is to pay money, actual payment or a valid tender thereof discharges the pledge. The tender may be made at any time before the pledged articles are sold for default. For example, a tender after the maturity of the obligation but before a sale for default is sufficient to discharge the pledgee's lien.[8] This means, of course, that nonperformance of the obligation does not transfer title to the pledgee. The pledgor, his representative, or assignee has a right of redemption until a valid sale of the property has been made. The right to redeem, however, may be lost through waiver and abandonment, by lapse of time under the Statute of Limitations, and, in some cases, by laches (unreasonable delay in asserting a right).

Enforcement of a Pledge. When the obligation for which the pledge has been made is not discharged, the pledgee may proceed to subject the pledged property to payment. He does not, however, by default of the bailor become the legal owner of the property. Thus, even when the parties agree that the pledgee shall have title upon default, courts are inclined to declare that the provision is without effect.[9]

> "A stipulation in the pledge that upon nonpayment the title shall become absolute in the pledgee is void." (Williams v. Schmeltz, 223 Mo. A. 477, 14 S. W. [2d] 966)

Upon default the pledgee may sell the subject matter of the pledge in one of two ways. He himself may sell the pledged articles after notice to the pledgor and the lapse of reasonable time for the latter to redeem; or he may petition

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[7] *Dewart* v. *Masser*, 40 Pa. 302.
[8] *Hyams* v. *Bamberger*, 10 Utah, 3, 36 P. 202.
[9] *Livingston* v. *Story*, 11 Pet. (U. S.) 351, 9 L. Ed. 746.

a court of equity for a judicial sale. The power to sell, being coupled with an interest, is irrevocable by the pledgor during his life and is not affected by his death. If the pledgee himself conducts a sale, he must do so in good faith and exert reasonable effort to obtain a fair price. In the absence of an expressed or implied contract, he must conduct the sale by public auction. Thus a sale on a board of exchange is not binding on the pledgor in the absence of agreement to that effect, as the sale is neither public nor auction.[10] When the pledge is a negotiable instrument, the pledgee may, instead of selling it, collect the amount called for.

> Unless prohibited by statute, "the parties may by their written agreement dispense with notice of the sale to the pledgor." (Atlantic Nat. Bank of Boston v. Korrick, 29 Ariz. 468, 242 P. 1009)

The right to enforce the pledge, however, arises only in the event of default. If there is a fixed time for the performance of the principal obligation, the pledgor is in default unless he discharges the obligation by the time fixed. If the obligation calls for payment on demand, a default occurs upon a demand and a refusal to pay. If no time has been fixed for the performance of the obligation, a default occurs in the event of nonperformance within a reasonable time after notice.

The proceeds of the sale are first applied to the payment of the obligation. When there are different debts secured, the pledgor is entitled to direct the application of the proceeds; but if he fails to do so at the time of making the pledge, the pledgee has the right to pay as he sees fit. The pledgor is entitled to any surplus only if he is the owner of the goods or has some special property in it. Thus, when a pledgor has authority from another to give his property as security for a debt, the true owner is entitled to the surplus.[11]

Pawns. The term *pawn* is often used to indicate a particular kind of pledge. When a chose in action, such as a bond, negotiable paper, or certificate of corporate stock, is given as security, the transaction is described as a pledge. When the

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[10] *Hagan* v. *Continental Nat. Bank*, 182 Mo. 319, 81 S. W. 171.
[11] *Farwell* v. *Importers, etc., Nat'l Bank*, 90 N. Y. 483.

pledge is of some other type of personal property, the transaction is termed a pawn. In the latter case the pledgor is called a *pawner*, and the pledgee is called a *pawnee*. Except as noted below, the principles of law governing pledges are applicable to pawns.

> A pawner of a ring made a tender of the principal and interest. The pawnbrokers refused the proffered money. The court declared that "there was a discharge of the lien that the parties had upon the property, and a refusal to return or a disposal of it thereafter was a conversion." (Bardon Loan Co. v. Boggs, 159 Okla. 196, 14 P. [2d] 947)

A person engaged in the business of lending money at interest, in which he requires a pawn or pledge of tangible personal property as security, is known as a *pawnbroker*. As the business of professional pawnbroking is generally regulated by statutes, the general rules applicable to pledges do not apply fully to the transactions of pawnbrokers. "The business of pawnbrokers, because of the facility it furnishes for the commission of crime and for its concealment, is one which belongs to a class upon which the strictest police regulations may be imposed. . . . In the case last cited it is said that 'it is a matter of common knowledge that thieves resort to these places to dispose of their stolen goods, and that unscrupulous and oftentimes criminal persons are engaged in the business. The business therefore comes expressly within the control of the police power of the state, and is properly subject to reasonable rules and regulations.' " [12] State and municipal regulations to a considerable extent control pawnbroking by licensing persons who engage in it. The statutory provisions regulate the charges which may be made for loans and the general conduct of the business.

QUESTIONS

1. Wilder borrows fifty dollars from Merton. Several months later he delivers a lawnmower to Merton, who agrees to store it for seven months. When Wilder returns for the lawnmower, Merton refuses to redeliver it on the ground that it is a pledge for the fifty dollars which Wilder owes him. Wilder brings an action of replevin to recover possession of the machine. Is he entitled to judgment?

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[12] *Elsner Bros.* v. *Hawkins*, 113 Va. 47, 73 S. E. 479.

2. Cone delivers to Hector a stock certificate representing one hundred shares in a given company, as security for a loan payable three months later. At the end of two months Hector, upon Cone's request, returns the certificate. A month later Cone's creditors seize the stock certificate as part of Cone's assets to satisfy their claim. Hector brings an action against the creditors to subject the property to a pledgee's lien. Is he entitled to judgment?

3. Partridge delivers a radio set to Helmar as security for a debt of one hundred and fifty dollars. Partridge, who is planning to entertain friends one evening, takes the radio without Helmar's permission. The latter brings an action to recover damages from Partridge. Is he entitled to judgment?

4. Rolfe pledges ten shares of stock to Weidt as security for a debt of one hundred dollars payable in six months. Two months later Weidt borrows two hundred dollars from Crane and delivers the same stock to him as security. Rolfe brings an action in trover against Weidt to recover the value of the stock. Is he entitled to judgment?

5. Allen borrows seventy-five dollars from Skein and delivers to him as security a promissory note for the same amount executed by Gurner. Allen's obligation is unpaid at maturity. One week later the note becomes due. Gurner is able to pay the instrument but asks Skein for an extension of thirty days, which the latter allows. At the end of thirty days Gurner is totally insolvent. Skein then sues for the amount which Allen owes him. Is he entitled to judgment?

6. Armstrong delivers to Parlcoin a promissory note payable to the bearer as security for money borrowed by Aggate. When the debt owed by Aggate is due, it is paid. After a week has passed without Armstrong receiving the note from Parlcoin, Armstrong brings an action against Parlcoin to recover the value thereof. Is he entitled to judgment?

7. Keefer borrows eight hundred dollars from Groin to whom he delivers bonds valued at one thousand dollars as security for the debt. The debt is not paid by Keefer at maturity. Two days later he tenders the amount due to Groin who refuses to accept the money and to return the property. Keefer brings an action against Groin to recover the value of the bonds. Is Groin liable?

8. Jacobs pledged ten shares of stock to Hibbert as security for a debt. Upon default by Jacobs, the pledgee decided to sell the stock. Two days before the stock was sold, Jacobs died. His executor brought an action against Hibbert, contending that the power of the pledgee to sell had been revoked at Jacobs' death. Was this contention sound?

9. Mosley pledged twenty-five shares of stock to secure a loan of seventeen hundred dollars made by Burns to Cairn. Upon default Burns sold the stock for two thousand dollars. Burns retained all of the proceeds, contending that the difference between the proceeds of the sale of the stock and the amount of the debt belonged to him. Cairn brought an action to recover the excess sum. Was Cairn entitled to judgment?

Part IV—Innkeepers

Who Are Innkeepers. One who conducts an inn, hotel, or tavern is described as an innkeeper. Earlier a tavern was a place which provided food and drink but not lodging. Today the words *inn* and *tavern* are used interchangeably. The word *hotel* has largely supplanted both terms, although the several terms may be used synonymously.

An inn is defined as "a house, the proprietor of which holds out that he will receive all travelers and sojourners who are willing to pay a price adequate to the sort of accommodation provided, and who come in a situation in which they are fit to be received." [1] The older concept of an inn embraces functions not ordinarily thought of in connection with a modern hotel. In the absence of statutes, however, the early rules apply to modern inns. "Anciently it was the law that an innkeeper was one who held himself out as ready to receive all travelers and entertain them with both lodging and food, and, perhaps to feed and stable their horses; or, as the old expression ran, to provide entertainment 'for man and beast.' Changes in the mode of travel and the custom of furnishing food and lodging separately have relaxed the definition of an innkeeper." [2] Thus, even though a hotel is run on the European plan, it remains an inn in the eyes of the law.[3]

The essential characteristics of an inn or hotel are, first, that the proprietor is regularly engaged in the business; and, second, that he professes to entertain all fit persons who make applications for accommodations. For example, a farmer living in an isolated portion of the country and at various times entertaining travelers for compensation is not an innkeeper.[4]

Liabilities as Bailee. The innkeeper at common law is, generally speaking, an insurer of the safety of goods entrusted to his care. The extraordinary liability originated in the exigencies of former times. In early days the remote location of the inn and the presence of numerous thieves along the

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[1] *Nelson* v. *Johnson*, 104 Minn. 440, 116 N. W. 828.
[2] *Horton* v. *Terminal Hotel, etc., Co.*, 114 Mo. A. 357, 89 S. W. 363.
[3] *Huntley* v. *Stanchfield*, 168 Wis. 119, 169 N. W. 276.
[4] *Howth* v. *Franklin*, 20 Tex. 798.

highways made collusion between the latter and the innkeeper not only possible but likely.

> Although there is a tendency to restrict the common-law liability of an innkeeper, "it is indisputable that, in the absence of statuory limitations, common-law principles still obtain." (Davidson v. Madison Corporation, 231 App. Div. 421, 247 N. Y. S. 789)

There are, however, some exceptions to the general rule. The innkeeper is not liable for losses caused by an act of God or of a public enemy. To illustrate, the innkeeper is not liable if the goods of a guest are destroyed by a tornado.[5] He is not liable for losses arising out of the inherent nature of the property itself. Nor is he liable if the loss is due to the fault of the guest.

> When goods of a guest were damaged in a flooded hotel basement after an unusually heavy rainfall, the hotelkeeper was liable if he negligently failed to use the usual devices which would have prevented the overflow. (Wolf Hotel Co. v. Parker, 87 Ind. A. 333, 158 N. E. 294)

The innkeeper may limit his liability by contract or by giving actual notice of the limitation to the guest. Reasonable rules which tend to facilitate the protection of the guests' property are frequently published and enforced by the management. To illustrate, the proprietor may require that valuables be deposited in the office. If a guest knowing of this rule fails to comply with it, the innkeeper is relieved from liability for losses of certain character.[6]

> A regulation requiring a guest to place his baggage in charge of a porter, when a room had not been assigned to him, unless the guest retained custody of such baggage, "was a reasonable and proper regulation." (Widen v. Warren Hotel Co., 262 Mass. 41, 159 N. E. 456)

In many states statutes limit, or provide a method for limiting, the liability of an innkeeper. The statutes may limit the extent of liability, reduce the liability of insurer to that of an ordinary bailee, or permit the innkeeper to limit his lia-

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[5] *Holstein* v. *Phillips*, 146 N. C. 266, 59 S. E. 990.
[6] *Fuller* v. *Coats*, 18 Ohio St. 343.

bility by contract or by posting a notice of the limitation. By way of illustration, some statutes relieve the innkeeper from liability when directions for depositing property are posted on the doors of the rooms occupied, but the guest fails to comply with them.[7]

Who Are Guests. An innkeeper, holding the goods of another as bailee, is under this extraordinary liability only when the bailor is a guest. Early courts defined a guest as one who was a traveler. The modern definition, however, is not so limited. A guest need not be a traveler nor come from a distance. For example, a person living within a short distance of an inn, one evening engaged a room at the inn and remained there over night. It was held that he was entitled to protection as a guest.[8] It seems that the essential element in the relation of innkeeper and guest is that the person receiving entertainment be a transient.

> "One of the essential elements of the innkeeper-guest relationship at common law was that the person to whom accommodation was extended must be a transient, coming to the inn for a more or less temporary stay." (Brams v. Briggs, 272 Mich. 38, 260 N. W. 785)

The relation does not begin until a person is received as a guest by the innkeeper. Many persons enter an inn without expectation of receiving accommodations offered to transients. They are not guests. For example, a person who enters an inn for the purpose of using the stationery which is supplied gratuitously is not a guest.[9] This is equally true when a person enters at the invitation of a guest or attends a ball or banquet given at the inn.

> "A mere guest of the registered occupant of a room at a hotel who shares such room with its occupant without the knowledge or consent of the hotel management, would not be a guest of the hotel." (Moody v. Kenny, 153 La. 1007, 97 S. 21)

The relation terminates when the guest pays for his accommodations and departs, or when he ceases to be a tran-

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[7] *Beale* v. *Posey*, 72 Ala. 323.
[8] *Walling* v. *Potter*, 35 Conn. 183.
[9] *Parker* v. *Dixon*, 132 Minn. 367, 157 N. W. 583.

sient, as when he arranges for a more or less permanent residence at the inn and becomes a boarder or lodger. The transition from the former to the latter status must, however, be clearly indicated as it is not proved by the mere fact that one remains at the inn for a long period. "The length of time that a man is at an inn makes no difference, whether a week, or a month, or longer; so, although he is not strictly transient, he retains his character as a traveler." [10]

Lien of an Innkeeper. An innkeeper, having exceptional duties and being required to receive all fit persons who apply, is entitled to a lien on the goods of his guests for the reasonable value of the accommodations furnished. Since the lien does not arise out of contract, but is imposed by law, it exists even when the guests are infants or other persons under a legal incapacity to make binding agreements. Thus the effects of a married woman, who at common law could not enter into a contract, are subject to an innkeeper's lien for her entertainment.[11]

> It was held that an automobile in a garage was not "baggage" within the meaning of a statute which gave hotelkeepers a lien upon "baggage of any guest which may be in his hotel." (Cedar Rapids Inv. Co. v. Commodore Hotel Co., 205 Iowa 736, 218 N. W. 510)

In general, all goods brought by a guest to an inn, except wearing apparel actually being worn, are subject to this lien. It extends to the property of another brought by the guests, if the proprietor is ignorant of the true ownership. The reason for this rule is that "unless the innkeeper's lien extends to all the luggage and goods which the guest brings to the inn, and for which the innkeeper becomes responsible as an insurer, an opportunity is afforded by which great fraud might be perpetrated upon the innkeeper through a relative or other person claiming the ownership of luggage and goods in the possession of the guest. So long as public policy requires that an innkeeper be held to the extraordinary and severe responsibility prescribed by the common law, the same

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[10] *Hancock* v. *Rand*, 94 N. Y. 10.
[11] *Gordon* v. *Silber*, 25 Q. B. D. 491.

considerations of public policy require that the rule of the common law be retained in its entirety and that the innkeeper have a lien upon the luggage and goods in the possession of the guest for payment of his reasonable charges." [12] This rule has been modified or abolished by statute in some jurisdictions. The innkeeper's lien, clearly enough, does not apply to the goods of a third person, if the ownership is known to the proprietor of the inn, unless the goods are entrusted to the guest with the intent that he carry them to the inn.

> A statute abrogated the common-law rule that an innkeeper has a lien on all the property brought to the inn, unless he knows that the guest does not own such property. (Nicholas v. Baldwin Piano Co., 71 Ind. A. 209, 123 N. E. 226)

The lien of the innkeeper is terminated by payment of the charges or by any act of the innkeeper which amounts to a conversion of the goods. It is also terminated if the innkeeper surrenders the goods to the guest, except when they are given to him for temporary use.

The innkeeper at common law cannot enforce his lien by a sale, but he must seek a foreclosure in a court of equity. This inconvenient method of enforcing his lien has been generally changed by statutes which permit the innkeeper to sell the goods.

Boardinghouse Keepers. The innkeeper owes extraordinary duties only to guests as defined above. In relation to some of his patrons, he may occupy the position of a boardinghouse or a lodginghouse keeper. In this event his duties and liabilities are less severe.

> McIntosh's occupancy of a room at the Standish Hotel was of a permanent nature, lasting over a period of two years, at a fixed rental per month. It was held that prima facie "he was a lodger or boarder rather than a guest." (McIntosh v. Shops, 92 Oreg. 307, 180 P. 593)

A boardinghouse or a lodginghouse keeper, in the absence of contract or statutes, is liable for losses of, or injuries to,

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[12] *Waters* v. *Gerard*, 189 N. Y. 302, 82 N. E. 143.

goods in his possession only as a bailee in an ordinary bailment for mutual benefit. Since he is under no duty to accept all who apply for accommodations, at common law he is not given a lien on the effects of his lodgers or boarders. The parties may, of course, provide for a lien by agreement. In a number of states legislation giving a lien to a boardinghouse or a lodginghouse keeper, or both, has been enacted. The rights of the parties in these states depend on the wording of the particular statute. Thus, in a state in which a statute gave a lien to boardinghouse and lodginghouse keepers, it was held that its provisions did not apply to a boarding school.[13]

QUESTIONS

1. Saas is engaged in operating a ranch in the western part of the United States near one of the coast-to-coast highways. He frequently furnishes board and lodging for pay to motorists. Is Saas an innkeeper?

2. Sheean owns a large building which is divided into sleeping rooms. He notifies the employees of neighboring industrial organizations that these rooms may be rented by persons furnishing certain recommendations. He also offers to furnish board to such persons. It is contended that Sheean is an innkeeper. Do you agree?

3. Granger is a guest at an inn for three days. During this time his trunk is in the charge of the porter. When Granger is ready to depart, his trunk is missing. Thereafter he brings an action to recover damages from the innkeeper. The innkeeper proves that he had exercised ordinary care in protecting Granger's property. Is Granger entitled to judgment?

4. Taylor lives directly across the street from the Capitol Hotel. One evening while his family is away, Taylor leaves his keys at the office and cannot gain entrance to his home. He thereupon goes across the street and engages a room for the night at the Capitol Hotel. Has the relation of innkeeper and guest been established?

5. A hotel in California has a drinking fountain in the lobby for the convenience of its guests. The water supplied by the fountain is piped directly from a stream high in the mountains which are near by. Barnaby, who is visiting the city for a day, knows of the quality of this water and stops to obtain a drink from the fountain. Is he a guest of the hotel?

6. Gildersleeve, arriving in Colorado from New York, registers and remains at a hotel. Six months later some of Gildersleeve's property is

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[13] *Talbott* v. *Southern Seminary*, 131 Va. 576, 109 S. E. 440.

missing from the hotel. Gildersleeve brings an action against the hotelkeeper. The liability of the latter depends upon the status of Gildersleeve. The hotelkeeper contends that the relation of innkeeper and guest does not exist. Do you agree?

7. Katuin, after remaining a week at a hotel, is unable to pay the amount of charges for the accommodations. The owner of the hotel, when informed of Katuin's financial condition, takes possession of the latter's hat, overcoat, and suitcase, and refuses to give them up until the bill is paid. Katuin brings an action of replevin against the owner of the hotel to recover these articles. Is he entitled to judgment?

8. Coulter stays in the home of a family which is engaged in furnishing board and lodging to a limited number of persons. When he attempts to move to another part of the city, the lodginghouse keeper refuses to allow him to take his baggage until payment is made for board and room covering the last two weeks. Coulter brings an action of replevin to recover possession of the baggage. Is he entitled to judgment?

9. Soares borrowed Hayward's gladstone bag to take with him on a vacation trip. At one hotel where Soares was a guest, the bag was retained by the hotelkeeper because Soares failed to pay for his accommodations. Hayward went to the hotel and demanded the bag. The hotelkeeper refused to deliver it until the bill was paid. Hayward brought an action for damages against the hotelkeeper. Was he entitled to judgment?

10. Younkers registers at a hotel and places two trunks in the charge of the porter. He is permitted to take one of them away daily to use in making displays to the businessmen upon whom he calls. One day he fails to bring the trunk back to the hotel. The same day he telephones the hotelkeeper that he does not intend to pay his bill. The hotelkeeper contends that he has a lien on both trunks for the charges for the accommodations furnished Younkers. Is his contention sound?

Part V—Factors and Warehousemen

Factors. A factor is a bailee of a special type. He is a person who, for a recompense usually termed *factorage* or *commission*, sells goods which are consigned to him. A *del credere factor* is one who for an additional recompense "guaranties the solvency of the purchaser and his performance of the contract." [1] The usual definition of the relation of principal and factor includes only the authority to sell (which is the ordinary practice), but in some instances the definition has been enlarged. For example, one statute defines a factor as "an agent who is employed to buy or sell property in his own name, and who is intrusted by his principal with the possession thereof." [2]

> Under a statute, a dealer in used automobiles who took possession of a car with authority to sell was held to be a factor. (Kenny v. Christianson, 200 Calif. 419, 253 P. 715)

It is obvious from the definition of a factor that the relation of principal and factor is a special form of agency as well as a special form of bailment. A factor differs from the ordinary agent in several respects. The principal difference is that whereas the agent need not have possession of the principal's property, the factor must have actual or constructive possession of it. The chief difference between a factor and an ordinary bailee is that the former receives goods to sell but the latter receives them to be disposed of at the bailor's direction. Thus, when goods are delivered to a person merely for the purpose of transportation, the person is an ordinary bailee and not a factor.[3]

Rights and Duties of Factors. The care required of a factor in the protection of the goods is that of a bailee in an ordinary mutual-benefit bailment. The factor is under a duty not to mix the goods consigned to him with his own or another's property, unless authorized by his principal to do

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[1] *Commercial Credit Co.* v. *Girard Nat'l Bank*, 246 Pa. 88, 92 A. 44.
[2] *Turner* v. *Crumpton*, 21 N. Dak. 294, 130 N. W. 937.
[3] *Rowland* v. *Dolby*, 100 Md. 272, 59 A. 666.

so.[4] By usage the factor is usually permitted to mix goods of different owners when the goods are fungible in character. To illustrate, when wheat consigned to a factor must be stored, he may place it in an elevator, mixing it with other wheat of equal grade.[5]

> "'It is a factor's duty to care for and protect the goods which have been consigned to him, with a reasonable degree of prudence and diligence.'" (Mann v. W. C. Crenshaw Co., 158 Va. 193, 163 S. E. 375)

The factor, in making a sale of goods, must act in accordance with instructions of the consignor. In the absence of express directions, the factor may sell in the manner usually and customarily employed by him. He has no authority to sell or pledge the goods for purposes of his own, unless authorized expressly or impliedly by the principal to do so. He has no power to exchange or barter the goods. If the factor unlawfully transfers the goods, the transferee acquires no title or right against the owner at common law. For example, if a factor pledges goods for his own debt, the owner may replevin the goods from the pledgee.[6]

> "A factor who has completed sale for his principal has, thereafter, ordinarily no implied authority to rescind the sale, or discharge the purchaser from its obligation." (Gadsden County Tobacco Co. v. Corry, 103 Fla. 217, 137 S. 255)

The factor has a lien on the goods of the principal in his possession for expenses, advances, and compensation. It is a general lien in that it may be exercised against any of the principal's goods coming into his possession. It is a possessory lien and is lost by relinquishment of possession to the principal. The lien may also be lost by misconduct of the factor. To illustrate, if the factor deals with the goods contrarily to his instructions, as by selling wheat at a time later than directed, he loses his lien on money deposited for indemnity.[7]

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[4] The general duties of an agent to his principal are also applicable to a factor.
[5] *Davis* v. *Kobe*, 36 Minn. 214, 30 N. W. 662.
[6] *Gray* v. *Agnew*, 95 Ill. 315.
[7] *Jones* v. *Marks*, 40 Ill. 313.

Factors' Acts. The common-law rule that an unauthorized sale or pledge of the goods or document of title did not pass title, led to many impositions on innocent third persons. In the early part of the nineteenth century a statute was enacted in England to cure some of these abuses. Since then similar statutes have been passed in most of our states. These statutes are known as *factors' acts.*

Although the terms of these statutes vary in detail, they agree in protecting innocent third persons who receive goods for value from the factor. To such persons a factor in possession of the goods or document of title may give a valid title as against the true owner. Although these statutes change the common-law rule as to transfers by factors, they apply to these transactions "the common-law rule that where one of two innocent persons must suffer loss from the act of a third person, such loss shall be borne by him who has placed the third person in the position which enabled him to do the act causing the loss." [8]

Warehousemen. A person engaged in the business of storing the goods of another for compensation or profit is a *warehouseman.*[9] A *warehouse* is a place in which goods may be stored for hire. The term *public warehouse* describes a place which holds itself out generally to serve the whole public. On the other hand, it usually indicates warehouses within a classification prescribed by statutes.

> One statute reads: "Public warehouses shall embrace all warehouses, elevators, and granaries in which is stored grain in bulk and in which grain of different owners is mixed together, or in which grain is stored in such a manner that the identity of different lots cannot be accurately preserved; provided that no warehouse, elevator, or granary with a capacity less than fifty thousand bushels shall be considered a public warehouse." (State v. Smith, 114 Mo. 180, 21 S. W. 493)

The rights and duties of a warehouseman, in the absence of statutes, are in the main the same as those of a bailee in

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[8] *Kingston Cotton Mills* v. *Kuhne,* 113 N. Y. S. 779.
[9] *State* v. *Tiesberg,* 196 Wis. 419, 220 N. W. 217.

an ordinary mutual-benefit bailment. The public warehouseman, however, has a common-law lien against the goods for reasonable charges.[10] It is a specific lien in that it attaches only for charges involved in the particular transaction. The specific rights and duties of a warehouseman today can be determined only by an examination of the statutes in a given state. Because of its public nature, the business of warehousemen is subject to legislative control. Most states have passed warehouse acts prescribing regulations as to charges, bonds, liens, inspections, and general methods of transacting business.

Warehouse Receipts. The written acknowledgment of a warehouseman that the property of a named person has been received for storage is known as a *warehouse receipt.* It has been defined as "a written simple contract between the owner of the goods and the warehouseman, the latter to store the goods and the former to pay compensation for that service." [11] It is generally held that a valid receipt can be issued only for goods actually in possession of the warehouseman.[12] Courts in the different states are not in agreement as to whether a receipt may be issued by a warehouseman on his own goods. Many differences of opinion have been eliminated in states which have adopted the Uniform Warehouse Receipts Act.

> The Uniform Warehouse Receipts Act has been adopted in Ala., Alaska, Ariz., Ark., Calif., Colo., Conn., Del., Dist. of Columbia, Fla., Ga., Ida., Ill., Ind., Iowa, Kans., Ky., La., Me., Md., Mass., Mich., Minn., Miss., Mo., Mont., Nebr., Nev., N. H., N. J., N. M., N. Y., N. C., N. D., Ohio, Okla., Oreg., Pa., Philippine Islands, Puerto Rico, R. I., S. C., S. D., Tenn., Tex., Utah, Vt., Va., Wash., W. Va., Wis., and Wyo. (Uniform Laws Annotated, vol. 3, Cumulative Annual Pocket Part for use during 1947)

Unless a statute provides otherwise, a warehouse receipt need not be in any particular form. It must, of course, indi-

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[10] *Uniform Warehouse Receipts Act*, §27.

[11] *Hale* v. *Milwaukee Dock Co.*, 29 Wis. 488.

[12] The Uniform Warehouse Receipts Act makes the issuance of a receipt for goods not received by the warehouseman a crime punishable by imprisonment not exceeding five years, or by a fine not exceeding $5,000, or by both. §50.

Lot G 70750

CENTRAL AVE. AND AUGUSTA ST., CINCINNATI O. November 1, 19

RECEIVED FOR ACCOUNT OF L. M. Walker

4938 Huron Avenue

CAR NUMBER

PKGS.	SAID TO CONTAIN	LOCATION	WEIGHT	SYMBOL	RATE
1	Kitchen Range	C7-6	585#	A	

REMARKS

CHECKED M. R.

RECHECKED D O.

NOT NEGOTIABLE GENERAL STORAGE

This receipt evidences only delivery on platform of the goods enumerated. Condition and quality are unknown; they are left at owner's risk and must be removed at once by owner when so requested. CINCINNATI TERMINAL WAREHOUSES, INC., claims a lien for all lawful charges and other expenses or advances.

No Goods Delivered without a written order. Please Specify Lot Number when Ordering Goods from Storage. L 13

CINCINNATI TERMINAL WAREHOUSES, INC.

WAREHOUSE RECEIPT

cate that goods are held in storage and give a description of them. The Uniform Warehouse Receipts Act provides: "Warehouse receipts need not be in any particular form, but every such receipt must embody within its written or printed terms: (a) the location of the warehouse in which the goods are stored; (b) the date of the issue of the receipt; (c) the consecutive number of the receipt; (d) a statement whether the goods will be delivered to the bearer, to a specified person, or to a specified person or his order; (e) the rate of storage charges; (f) a description of the goods or the packages containing them; (g) the signature of the warehouseman, which may be made by his authorized agent; (h) if the receipt is issued for goods of which the warehouseman is owner, either

solely or jointly or in common with others, the fact of such ownership; and (i) a statement of the amount of advances made and of liabilities incurred for which the warehouseman claims a lien. If the precise amount of such advances made or of such liabilities incurred is, at the time of the issue of the receipt, unknown to the warehouseman or to his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof is sufficient." [13]

Rights of Receipt Holders. A warehouse receipt at common law could only be assigned, and such transfers were governed by the principles of law governing the assignment of simple contracts generally. Courts under the common law refused to treat these documents of title as having the elements of negotiability. To illustrate, when by mistake two receipts were made out to the order of the person who placed the goods in storage, it was held that delivery of the goods to an assignee of one receipt was a valid defense against the assignee of the other.[14] A warehouse receipt may be transferred by a written assignment or by delivery of the receipt. Those transfers are valid in most states without notice to the warehouseman. Since the receipt is nonnegotiable, the purchaser is in the position of the ordinary assignee, and he takes the instrument subject to any defenses which are valid against his transferor. In other words, he acquires only the right possessed by the transferor.

> The purchaser of a nonnegotiable warehouse receipt from a joint owner takes the instrument subject to the rights of the other joint owner. (Bache v. Hinde, 6 F. [2d] 508)

The common-law rules as to the negotiability of warehouse receipts have, however, been changed in a number of states by statutes expressly declaring certain specified warehouse receipts to be negotiable. The Uniform Warehouse Receipts Act contains the following provision: "A receipt in

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[13] §3.
[14] *Toledo Second Nat'l Bank* v. *Walbridge*, 19 Ohio St. 419.

which it is stated that the goods received will be delivered to the depositor, or to any other specified person, is a non-negotiable receipt. A receipt in which it is stated that the goods received will be delivered to the bearer, or to the order of any person named in such receipt, is a negotiable receipt." [15]

These statutes, however, cannot in the nature of things place warehouse receipts in the class of negotiable instruments, such as bills and notes, so as to be governed by all of the rules which govern them. The general effect of the statutes which declare warehouse receipts to be negotiable is, first, to permit the transferee of the receipt to sue in his own name; second, to abrogate the rule requiring notice to the warehouseman; and, third, to give to the bona fide purchaser of the receipt a right to the goods free from any claims of prior parties which are not shown on the face of the instrument, or which are not known from other sources. For example, when the owner gives a receipt for cotton in payment of a gambling debt, the transferee may give to a bona fide purchaser a valid title as against the original owner.[16]

> A bank, taking in good faith and for value an indorsed warehouse receipt, took the instrument free from the equities of the warehouseman. (Augusta Bonded Public Warehouse Co. v. Georgia R. Bank, 166 Ga. 105, 142 S. E. 559)

In addition, the Uniform Warehouse Receipts Act provides that "a person who for value negotiates or transfers a receipt by indorsement or delivery, including one who assigns for value a claim secured by a receipt, unless the contrary intention appears, warrants: (a) that the receipt is genuine; (b) that he has a legal right to negotiate, or transfer it; (c) that he has knowledge of no fact which would impair the validity or worth of the receipt; (d) that he has a right to transfer the title to the goods, and the goods are merchantable or fit for the particular purpose whenever such warranties would have been implied, if the contract of the parties had been to transfer without a receipt of the goods represented thereby." [17]

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[15] §§5 and 6.
[16] *Danforth* v. *McElroy*, 121 Ala. 106, 25 S. 840.
[17] §45.

QUESTIONS

1. "The relation of principal and factor is a special form of agency as well as a special form of bailment." What is meant by this statement?

2. Cuneo is engaged in the business of selling fruit and vegetables which are consigned to him. Rathborn consigns to him a carload of potatoes. Cuneo sells them to Blakeman on credit. When Blakeman fails to pay for the goods, Rathborn brings an action against Cuneo for the amount due. Is he entitled to recover from Cuneo?

3. Kessinger consigned a tank car of oil to a factor with directions to sell the oil, pursuant to subsequent orders. The factor, while awaiting directions from Kessinger, placed the oil in a storage tank with oil owned by other parties. Kessinger brought an action against the factor for mixing his property with the property of another person. Was the factor liable?

4. Artman sends one hundred boxes of oranges to Keil for the purpose of selling them. Keil transfers the fruit to Hoyle in payment of an old debt. Artman brings an action of replevin to recover the goods from Hoyle. Is he entitled to judgment at common law?

5. Kellman forges a warehouse receipt which states that ten bales of cotton will be delivered to bearer. He later sells it to Harriman, who knows of the forgery. Harriman transfers the receipt to Stockton. When Stockton learns that the receipt is a forged instrument, he brings an action to recover damages from Harriman. Is he entitled to judgment?

6. A factor is not paid for selling a consignment of goods for Larkin. Sometime later Larkin consigns a car of wheat to the factor. The latter claims a lien on the wheat for some advances made thereon and for commissions due in connection with the previous transaction. Is he entitled to the lien?

7. "Any place in which goods may be stored for hire is a public warehouse." Do you agree with this statement?

8. Minnich stores some rugs in a public warehouse. When he takes them out, he is allowed thirty days in which to pay the charges. Two weeks later Minnich stores some furniture in the same warehouse for a period of a month. When the month has elapsed, Minnich pays the charges on the furniture. The warehouse refuses, however, to deliver the furniture until payment is made for the storage charges on the rugs. Minnich brings an action of replevin to recover the furniture. Is he entitled to judgment?

9. Pliny receives a warehouse receipt for certain goods which he deposited with a warehouse. He then transfers the receipt for value to Clark. When Clark calls for the goods, delivery is refused on the ground that the goods have been previously delivered to Pliny. Clark brings an action for damages against the warehouse. Is he entitled to recover?

CASES FOR REVIEW

1. Myrtle Armstrong went to the Yakima Hotel to purchase her lunch. After finishing the meal, she went upstairs to the ladies' lounge, which was maintained on the second floor for female guests. While descending the stairway, she caught her heel on the second step and fell to the lobby below. In an action brought against the hotel, the plaintiff contended that she was a guest at the time of the injury. Was this contention sound? (Armstrong v. Yakima Hotel Co., 75 Wash. 477, 135 P. 233)

2. The Security Storage & Trust Company, of Baltimore, Maryland, undertook for compensation to store the household goods of F. Ward Denys. When Denys returned from Europe, it was discovered that a part of the stored goods was damaged and that some of the articles were missing. Denys brought an action against the warehouseman to recover damages. What liability, if any, did the warehouseman have in respect to the safeguarding of the goods? (Security Storage & Trust Co. v. Denys, 119 Md. 330, 86 A. 613)

3. The Auto Service Company borrowed the sum of $500 from the Bank of Mobile and executed an instrument to the effect that it gave to the bank a certain Saxon Six automobile as security for the loan. The Auto Service Company retained possession of the car. James A. Lewis, a creditor, attached all the property of the Auto Service Company, including the Saxon Six automobile. The bank during subsequent litigation contended that it had rights in the car as a pledgee. Was this contention sound? (Lewis v. Bank of Mobile, 204 Ala. 689, 87 S. 176)

4. The Vulcanite Portland Cement Company, engaged in the manufacture and the sale of cement, under a contract of bailment for a period of one year, delivered a quantity of cement to the Atlantic Building Supply Company. Thereafter the Atlantic Building Supply Company took and used part of the cement for its own purposes. The Vulcanite Portland Cement Company terminated the bailment relation. Was it entitled to do so? (Atlantic Building Supply Co. v. Vulcanite Portland Cement Co., 203 N. Y. 133, 96 N. E. 370)

5. Amanda J. Revert held two notes for the sum of $2,000 each, secured by mortgages, executed by Simon Flink. She pledged the notes and the mortgages to secure payment of the sum of $489.31 that she borrowed. The pledgee, without her consent or knowledge, released the mortgages. Thereafter she brought an action against the pledgee to recover for the wrongful use of the pledged property. Was she entitled to judgment? (Revert v. Hesse, 184 Calif. 295, 193 P. 943)

6. Lillian Yielding, a minor, was placed by her father in the custody and under the control of a boarding school principal. The school retained her trunks for an unpaid board bill under a statute which gave boardinghouse keepers a lien for an unpaid board bill on the boarder's property. Miss Yielding brought an action against the school to recover

for a wrongful detention of her goods. Was she entitled to judgment? (Semple School for Girls v. Yielding, 16 Ala. A. 584, 80 S. 158)

7. William M. Bohan was the proprietor of a seashore inn, located on the Island of Great Tybee. He also conducted in a separate building on the seashore a bathhouse that was available upon payment of a consideration to the guests of the inn and other persons. Mrs. A. Walpert, while using the facilities of the bathhouse, lost a diamond brooch and ring that she had checked with an attendant. Thereafter she brought an action to hold Bohan liable as an innkeeper for the loss. Was she entitled to judgment? (Walpert v. Bohan, 126 Ga. 532, 55 S. E. 181)

8. Paul Adamsky, suffering from a delusion that someone was attempting to obtain his money, jumped from a window of a car as a train upon which he was a passenger drew into the station of Corliss, Wisconsin. During his flight, he lost or irresponsibly cast away a roll of money. Certain persons later found and took possession of the roll of money. In an action brought by the state against Thomas Burns, it was contended that a relation of bailment had been established. Do you agree? (Burns v. State, 145 Wis. 373, 128 N. W. 987)

9. The Walter A. Wood Harvester Company was the bailee of a quantity of twine delivered to it by John Dobry for keeping. Upon demand by Dobry, the company failed to return the twine simply because it had turned the goods over to T. C. Northwall without the permission of the bailor. Dobry brought an action against the company to recover for a refusal to redeliver the goods. Was he entitled to judgment? (Walter A. Wood Harvesting Co. v. Dobry, 59 Neb. 590, 81 N. W. 611)

10. F. Romeo, of New York City, consigned to Ricciardello & Bro., of New Haven, Connecticut, certain goods to be sold on commission. On the day the goods arrived, the factors sold for a lump sum their business, their goodwill, and their stock, including the goods of Romeo, to Guiseppe Martucci. Romeo brought an action under the common law to recover his goods. Was he entitled to judgment? (Romeo v. Martucci, 72 Conn. 504, 45 A. 1)

11. L. Billie Landrum was a guest at Fred Harvey's hotel. Her rings, which had been placed in the slip of a pillow at night, disappeared the next morning after a maid had removed the slip from the pillow. In an action to recover for the loss from the hotelkeeper, it was contended that under the common law the innkeeper was liable only for negligence in case of the loss of property belonging to a guest. Do you agree? (Landrum v. Harvey, 28 N. M. 243, 210 P. 104)

12. Jennie Bondy was engaged in business under the name of Madam Yovin in the city of New York. She delivered to the American Transfer Company certain robes and laces of great value for transportation to the city of Los Angeles, California. In an action brought by Mrs. Bondy against the American Transfer Company, the transportation company denied the right of the plaintiff to possession of the goods

merely on the ground that the goods did not belong to her. Was this a valid defense? (Bondy v. American Transfer Co., 15 Calif. A. 746, 115 P. 965)

13. Robert Wetherill & Company, a partnership, delivered two large boilers to the Downing Paper Company under a contract of bailment. Thereafter Francis G. Gallagher, a creditor of the Downing Paper Company, sought to hold the boilers when the paper company went into bankruptcy. The partnership brought an action against the creditor to recover possession of the boilers. Was the firm entitled to judgment? (Wetherill v. Gallagher, 217 Pa. 635, 66 A. 849)

14. Hoffman & Bros. purchased and paid for ten thousand bushels of peanuts from the State Prison of North Carolina. Superintendent Laughinghouse consented to the request of the buyers that the goods be left in a barn on the prison farm until wanted. In an action brought by the State Prison against Hoffman & Bros., a question arose as to the classification of the bailment relation. How should it be classified? (State Prison v. Hoffman & Bros., 159 N. C. 564, 76 S. E. 3)

15. Frank J. Norvell took certain trunks containing samples to the St. George Hotel in Dallas, Texas. The hotelkeepers knew that the sample trunks belonged to J. R. Torrey & Company. The trunks were retained to secure payment of Norvell's unpaid board bill under an alleged statutory right. The statute gave any hotelkeeper a "specific lien upon all property or baggage deposited with them for the amount of the charges against them or their owners if guests at such hotel." J. R. Torrey & Company brought an action against the owners of the hotel to recover for a wrongful retention of the trunks. Was it entitled to judgment? (Torrey v. McClellan, 17 Tex. Civ. A. 371, 43 S. W. 64)

16. Emery Chase held a note executed by his brother, Roland E. Chase. He pledged the note to secure a loan from the Farmers' Bank, of Tate, Tennessee, which was later consolidated with the Citizens' Bank & Trust Company. The sum borrowed from the bank was paid. Thereafter the bank brought an action against Roland E. Chase to collect on the note as pledgee thereof. Was it entitled to judgment? (Citizens' Bank & Trust Co. v. Chase, 151 Va. 65, 144 S. E. 464)

17. The Washington State Art Association requested A. E. Colburn, a manufacturer of jewelry in Seattle, Washington, to place some of his goods upon exhibition in a museum where curios and works of art were on exhibition. The goods of Colburn were lost by theft while in the museum. Colburn brought an action against the association to recover damages. The liability of the association, if any, depended upon its failure to exercise what degree of diligence to safeguard the jewelry? (Colburn v. Washington State Art Association, 80 Wash. 662, 141 P. 1153)

18. George O. Savage delivered a quantity of wheat to the Salem Mills Company. The wheat was delivered under an agreement whereby the company could use the wheat and upon demand pay its market value

or return an equal quantity of wheat of the same grade and quality. The wheat was destroyed by fire. In an action brought by Savage against the Salem Mills Company, it was contended that the foregoing transaction created the relation of bailor and bailee. Do you agree with this contention? (Savage v. Salem Mills Co., 48 Oreg. 1, 85 P. 69)

19. The city of Seattle, Washington, passed an ordinance that prohibited any person engaging in the business of pawnbroking without a license and prohibited the issuance of a license to any person who was not a citizen of the United States. R. Asakura, a subject of the Emperor of Japan, brought an action to restrain the city from arresting him for pawnbroking without a license. Was he entitled to judgment? (Asakura v. City of Seattle, 122 Wash. 81, 210 P. 30)

20. S. Normile hired the use of a grading outfit, consisting of a steam shovel, a number of dump cars, two engines, and other equipment, under an agreement to pay the sum of $50 a day. Thereafter the German-American Bank of Seattle brought an action against Normile to recover a sum alleged to be due under the bailment contract. Normile set up a counterclaim for the amount of money he had expended in making repairs. Was he entitled to such money? (German-American Bank of Seattle v. Normile, 84 Wash. 368, 144 P. 289)

21. Jay M. Raynor, of Englewood, New Jersey, had a bay mare for sale. Herman Sheffler borrowed the mare until three o'clock in the afternoon, for the purpose of going to Hackensack "to make a dollar or two." Instead of returning by the direct route, Sheffler returned by a much longer route through several other places, at which he transacted business. About seven in the evening, at a place called Leonia, the horse's leg was injured so that the animal had to be killed. Raynor brought an action against Sheffler to recover the value of the animal. Was he entitled to judgment? (Raynor v. Sheffler, 79 N. J. L. 340, 75 A. 748)

22. L. A. Fitzpatrick obtained from the Bank of Forrest City, Arkansas, the sum of $100 on a draft that he drew on the Fitzpatrick Drug Company, of Helena, Arkansas. He pledged a certificate of purchase at a tax sale to secure payment of the $100. When the draft was protested for nonpayment and Fitzpatrick failed to pay the amount thereof, the bank sold the certificate at a private sale. Was it entitled to do so? (Fitzpatrick v. Bank of Forrest City, 95 Ark. 542, 129 S. W. 795)

23. The owners of the motor tug Gladys placed the vessel in the custody of the Marine Construction Company. While repairs were being made, the vessel was seriously injured. It was contended that the Marine Construction Company was a bailee of the tug. Do you agree? (The Gladys, 49 F. Supp. 780)

24. Reiling was a bailee of certain furniture in a bailment for the sole benefit of the bailor. It was contended that if Reiling destroyed the goods, he would be liable to the bailor for conversion. Was this contention sound? (Borg & Power Furniture Co. v. Reiling, 213 Minn. 539, 7 N. W. [2d] 310)

Chapter VIII

CARRIERS AND SHIPPERS OR PASSENGERS

Part I—General Considerations

Introduction. Transportation is the most important single device utilized in the field of marketing. When raw materials must be gathered from distant places, transportation is equally important in the field of production. For the most part the transportation of raw or finished materials to the manufacturer or to the consumer is entrusted to persons or companies who are engaged in this form of service. The business of carriers has expanded more and more as the business world has become increasingly dependent upon transportation agencies. The huge enterprises of modern times have been made possible and continue to exist largely because they can by means of carriers reach the far corners of the earth in search for raw materials and for markets in which to dispose of their finished products.

The role played by carriers in economic society did not begin to assume prominence until the latter half of the nineteenth century. The growth of the business of carriers was more or less synchronized with the settlement of the great western portions of our country. Railways were encouraged and aided as means of furthering the process of settlement and development, and the development of these regions in turn demanded further expansion of them.

The relation between the shipper of goods and the carrier employed to transport them gives rise to numerous problems, varying in nature, seriousness, and complexity. In general these problems center around the duty of the carrier in respect to the receipt and transportation of goods, the liability of the carrier for injuries to or loss of the goods, and the rights of the carrier arising out of the performance of services.

Definitions. A carrier is one who undertakes the transportation of persons or goods. One engaged in the transportation

of persons is a *carrier of persons*; one engaged in the transportation of goods is a *carrier of goods*. The *consignor* or *shipper* is one who delivers goods to the carrier for shipment. The *consignee* is one to whom the goods are addressed and to whom the carrier is under a duty to deliver them.

Courts, in defining "carrier," emphasize "for hire," and they declare that one who undertakes to carry goods gratuitously is a "mandatory." (Smith v. State, 199 Ind. 217, 156 N. E. 513)

A carrier of goods is a bailee whose duty requires him to transport the subject matter of the bailment from place to place. If a bailee is under a duty to transport goods, he is a carrier regardless of the means of conveyance used. It is immaterial whether the transportation is by water or land. Nor is the bailee's status as a carrier affected by the fact that the carriage is for a long or short distance.

Classification. Carriers are divided into two classes, namely, common carriers and private carriers.

Common Carriers. A common carrier has been defined as "one who undertakes for hire to carry from place to place the goods of all persons indifferently." [1] There have been many definitions of a common carrier, but they all embody certain essential characteristics. In the first place, the carrier must hold itself out as engaged in a public employment to serve all who apply. Thus one who occasionally or even frequently brings goods from the market at the request of a neighbor is not a common carrier.[2] On the other hand, owners of baggage wagons, drays, wagon trains, carts, and lighters are frequently held to be common carriers. Whether a person has so held himself out as to constitute himself a common carrier is a question of fact for the jury to determine in view of all the circumstances.

The owner of a building in which he operates an elevator was deemed "not a common carrier." (Southern Ry. Co. v. Taylor, 16 F. [2d] 517)

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[1] *Maslin* v. *Baltimore, etc., R. R. Co.*, 14 W. Va. 180.
[2] *Samms* v. *Stewart*, 20 Ohio 69.

In the second place, the transportation must be for compensation. There need not, however, be an express contract for remuneration; it is sufficient if the right to compensation may be inferred from the nature of the business or from usage. When the service is performed gratuitously, the carrier is not as to this transaction a common carrier, but merely a bailee in a bailment for the sole benefit of the bailor.[3] Even though the particular transportation be made without charge, it may nevertheless be for hire if it is a part of a transaction for which the carrier received a consideration. For example, a carrier executed an agreement with a contractor to do its construction work. Under the terms of the agreement, the materials and tools of the contractor were to be transported free of charge from one place of work to another. The company was held liable as a common carrier for losses.[4]

> It is not necessary that a common carrier own the means of transportation. (Highway Freight Forwarding Co. v. Public Service Commission, 108 Pa. Super. 178, 164 A. 835)

Private Carriers. Private carriers are "persons who undertake to transport goods in a particular instance only, not making it their vocation, nor holding themselves out to the public ready to act for all who desire their services." [5] As stated above, whether one is a common carrier or a private carrier is a question of fact to be decided in view of the circumstances of each case. The rights, duties, and liabilities of the private carrier need not be discussed in this chapter, as they are for the most part governed by the rules applicable to ordinary bailees.

Receipt of Goods. As in other bailments a common carrier, as bailee, incurs no liability with respect to the care and custody of goods until they shall have been placed in its possession. "The receipt of the goods lies at the foundation of the contract to carry and deliver." [6] In other words, the goods

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[3] *Ante*, p. 464.
[4] *Gulf, etc., Ry. Co.* v. *Gillespie*, 54 Tex. Civ. A. 593, 118 S. W. 628.
[5] *Brown* v. *N. Y. Cent. R. Co.*, 75 Hun 355, 27 N. Y. S. 69.
[6] *Pollard* v. *Vinton*, 105 U. S. 7, 26 L. Ed. 998.

must be delivered by the shipper and received by the carrier to establish the relation of shipper and common carrier.

Delivery. A valid delivery of goods can be made only at the place and during the time stipulated by the carrier. A carrier may make reasonable regulations as to the place and time freight will be received. A delivery at any other time or place does not as a general rule place any responsibility on the carrier in respect to the goods. For example, when the owner deposits goods along the right of way, at sidings or at switches, instead of taking them to the regular station, a valid delivery to the carrier has not been made.[7] If, however, the carrier directs that goods shall be placed elsewhere than the usual receiving station, a deposit at that place constitutes a delivery.

> There is a sufficient delivery when goods are deposited "at a place specifically designated by the contract." (First Nat. Bank v. Missouri Pac. Ry. Co., 220 Mo. A. 941, 278 S. W. 1075)

Notice. The freight must be delivered to the carrier or its agent. "If it is merely deposited in the yard of an inn, or upon a wharf to which the carrier resorts, or is placed in the carrier's cart, vessel, or carriage, without the knowledge and acceptance of the carrier, his servants or agents, there would be no bailment or delivery of the property, and he, consequently, could not be made responsible for its loss." [8] Hence, in addition to the delivery to the premises, notice should ordinarily be given to the carrier. This general rule, however, does not apply when there is a special agreement, custom, or usage to the contrary. In these cases actual notice need not be given. To illustrate, when, in accordance with custom, cotton was placed near the receiving platform, it was held to be constructive notice, charging the carrier for any loss.[9]

Bills of Lading. When the carrier accepts goods for shipment, it ordinarily issues to the shipper a document known as a *bill of lading.* This instrument is a receipt for the goods and contains the terms of the contract of carriage. A bill of

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[7] *Wilson* v. *Atlanta, etc., R. R. Co.*, 82 Ga. 386, 9 S. E. 1076.
[8] *Merriam* v. *Hartford, etc., R. R. Co.*, 20 Conn. 354.
[9] *Montgomery, etc., Ry. Co.* v. *Kolb*, 73 Ala. 396.

lading is a symbol of the property and is known as a *document of title.* Title to goods may be passed to another by a transfer of the bill of lading for that purpose.

A bill of lading is usually made out in duplicate, and sometimes in triplicate. Although no particular form is essential, the Uniform Bills of Lading Act requires a bill of lading to embody the following terms: (1) the date of its issue; (2) the name of the person from whom the goods have been received; (3) the place where the goods have been received; (4) the place to which the goods are to be transported; (5) a statement whether the goods received will be delivered to a specified person or to the order of a specified person; (6) a description of the goods or of the packages containing them; and (7) the signature of the carrier.[10]

> The Uniform Bills of Lading Act has been adopted in Ala., Alaska, Ariz., Ark., Calif., Conn., Del., Ida., Ill., Ind., Iowa, La., Me., Md., Mass., Mich., Minn., Mo., Nev., N. H., N. J., N. Y., N. C., Ohio, Pa., R. I., S. C., Vt., Wash., and Wis. (Uniform Laws Annotated, vol. 4, Cumulative Annual Pocket Part for use during 1947)

The carrier, as against a bona fide transferee of the bill of lading, is bound by the recitals in the bill as to contents, quantity, or weight of the goods.[11] This is not true, however, when facts appear on the face of the bill which should keep the transferee from relying on the recital. Thus a carrier, acknowledging receipt of a barrel of eggs but noting that the contents of the barrel were unknown, was held not liable to a transferee of the bill who discovered that the barrel did not contain eggs.[12] A majority of courts hold that a carrier is not answerable to a bona fide purchaser of a bill of lading issued by an agent when no goods have been received. Courts taking this view defend it on the ground that an agent has no authority to issue bills under these circumstances. A few states hold that the carrier in such a case is estopped to deny the receipt of goods. The latter view is adopted by the Uniform Bill of Lading Act.[13]

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[10] §2.
[11] *Uniform Bills of Lading Act,* §23.
[12] *Miller* v. *Hannibal, etc., R. R. Co.,* 90 N. Y. 430.
[13] §23.

The carrier was not liable for shortage to the buyer of a bill of lading who knew that the letters "SLC" thereon indicated that the shipper and not the carrier loaded and counted the packages. (People's Sav. Bank v. Pere Marquette Ry. Co., 235 Mich. 399, 209 N. W. 182)

Negotiability. At common law a bill of lading is not negotiable, but it is transferable so as to pass title to the goods for which it stands. Such transfers, however, give the transferee only the rights possessed by the transferor. The rule applies even when the transferee is a purchaser for value in good faith without notice of defects. It does not apply, however, where a bona fide purchaser has been misled by some act of the owner. By way of illustration, an owner of a bill of lading indorses and delivers the bill to an agent. The agent sells it to a bona fide purchaser. The owner, having clothed the agent with apparent ownership, is, as against the bona fide purchaser, estopped to deny the validity of the transfer.[14] This is equally true when the owner is induced by fraud to transfer the bill to another who then sells it to a bona fide purchaser.

"The transfer of bills of lading will pass title to goods, unless the common law has been modified by statute." (Weyerhaeuser Timber Co. v. First Nat. Bank, 150 Oreg. 172, 38 P. [2d] 48)

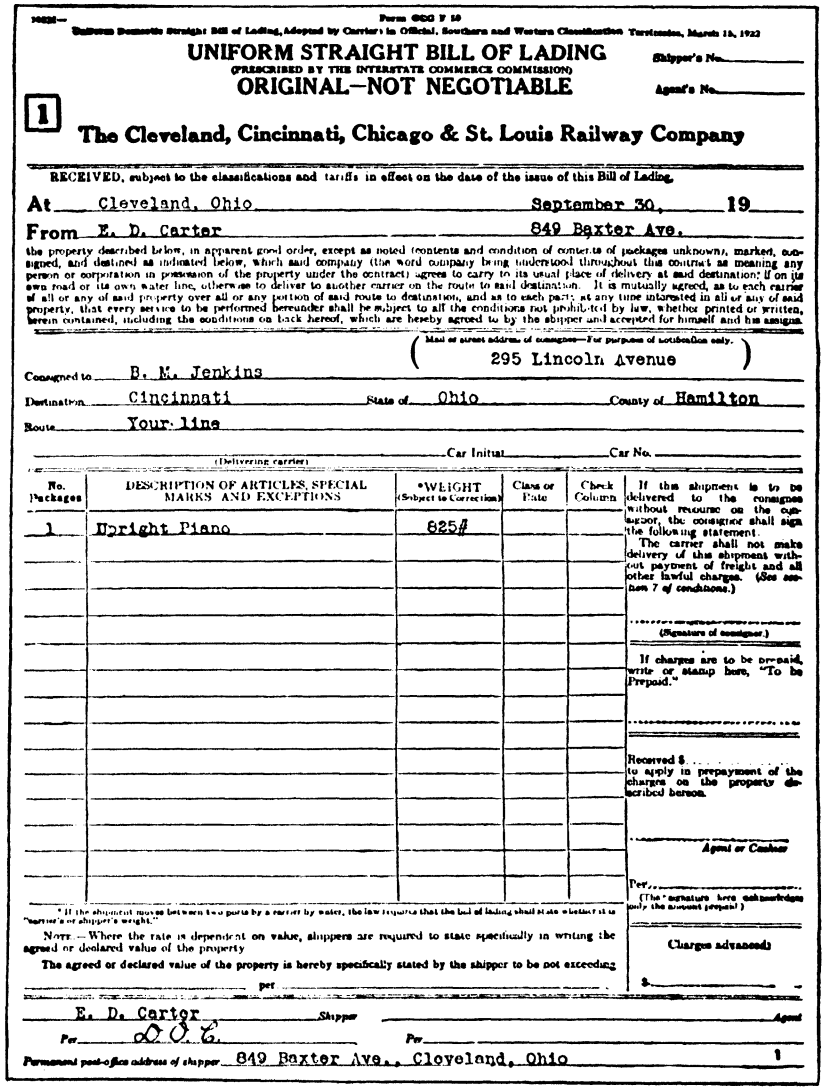
The negotiability of bills of lading has been enlarged by statutes in a number of states. Some of these statutes give bills of lading complete negotiability, while others do not go that far. The tendency is to give them such negotiability as will fully protect innocent purchasers.[15]

Under the provisions of the Uniform Bills of Lading Act, a bill of lading is a nonnegotiable or straight bill of lading when it states that "the goods are consigned or destined to a specified person." A bill of lading is a negotiable or order bill of lading when it states that "the goods are consigned or destined to the order of any person named in such bill." [16] A nonnegotiable bill of lading is required to be marked plainly "nonnegotiable" or "not negotiable." [17]

[14] *Com'l Bank* v. *J. K. Armsby Co.*, 120 Ga. 74, 47 S. E. 589.
[15] Examine the Uniform Sales Act, §§27-36.
[16] §§4 and 5.
[17] §8.

"'A straight bill cannot be negotiated free from existing equities and the indorsement of such a bill gives the transferee no additional rights.'" (Kasden v. New York, N. H. & H. R. Co., 104 Conn. 479, 133 A. 573)

The Uniform Bills of Lading Act provides that the person to whom a bill of lading has been negotiated acquires: (1)



Form GCG F 10

Uniform Domestic Straight Bill of Lading, Adopted by Carriers in Official, Southern and Western Classification Territories, March 1st, 1922

UNIFORM STRAIGHT BILL OF LADING

(PRESCRIBED BY THE INTERSTATE COMMERCE COMMISSION)

ORIGINAL—NOT NEGOTIABLE

Shipper's No.

Agent's No.

1

The Cleveland, Cincinnati, Chicago & St. Louis Railway Company

RECEIVED, subject to the classifications and tariffs in effect on the date of the issue of this Bill of Lading.

At Cleveland, Ohio September 30, 19

From E. D. Carter 849 Baxter Ave.

the property described below, in apparent good order, except as noted (contents and condition of contents of packages unknown), marked, consigned, and destined as indicated below, which said company (the word company being understood throughout this contract as meaning any person or corporation in possession of the property under the contract) agrees to carry to its usual place of delivery at said destination; if on its own road or its own water line, otherwise to deliver to another carrier on the route to said destination. It is mutually agreed, as to each carrier of all or any of said property over all or any portion of said route to destination, and as to each party at any time interested in all or any of said property, that every service to be performed hereunder shall be subject to all the conditions not prohibited by law, whether printed or written, herein contained, including the conditions on back hereof, which are hereby agreed to by the shipper and accepted for himself and his assigns.

(Mail or street address of consignee—For purposes of notification only. 295 Lincoln Avenue)

Consigned to B. K. Jenkins

Destination Cincinnati State of Ohio County of Hamilton

Route Your line

(Delivering carrier) Car Initial Car No.

No. Packages	DESCRIPTION OF ARTICLES, SPECIAL MARKS AND EXCEPTIONS	*WEIGHT (Subject to Correction)	Class or Rate	Check Column
1	Upright Piano	825#		

If the shipment is to be delivered to the consignee without recourse on the consignor, the consignee shall sign the following statement.

The carrier shall not make delivery of this shipment without payment of freight and all other lawful charges. (See section 7 of conditions.)

(Signature of consignor.)

If charges are to be prepaid, write or stamp here, "To be Prepaid."

Received $ to apply in prepayment of the charges on the property described hereon.

Agent or Cashier

Per (The signature here acknowledges only the amount prepaid.)

Charges advanced: $

* If the shipment moves between two ports by a carrier by water, the law requires that the bill of lading shall state whether it is "carrier's or shipper's weight."

NOTE.—Where the rate is dependent on value, shippers are required to state specifically in writing the agreed or declared value of the property.

The agreed or declared value of the property is hereby specifically stated by the shipper to be not exceeding per

E. D. Carter Shipper Agent

Per E. D. C. Per

Permanent post-office address of shipper 849 Baxter Ave., Cleveland, Ohio

1

BILL OF LADING

such title to the goods as the person negotiating the bill of lading to him had or had ability to convey to a purchaser in good faith for value, and also such title as the consignee or the consignor had or had such power to convey to a purchaser in good faith for value; and (2) a direct obligation of the carrier to hold possession of the goods for him according to the terms of the bill of lading as fully as if the carrier had contracted directly with him.[18] When he gives value for a negotiable bill of lading in good faith and without notice, his rights are not affected by the fact that such a negotiation was a breach of duty on the part of the person making the negotiation or by the fact that the owner had been deprived of the possession of the bill of lading by fraud, duress, conversion, mistake, or accident.[19]

> A bill of lading, calling for delivery of a quantity of cotton to the order of Manget Bros., without the indorsement of Manget Bros. came into the hands of a bank. It was held that there had not been a negotiation of the instrument; hence the bank took no better title than possessed by its transferor. (John S. Hale Co. v. Beley Cotton Co., 154 Tenn. 689, 290 S. W. 994)

The Uniform Bills of Lading Act declares also that a person who negotiates or transfers a bill of lading for value by indorsement or by delivery, unless a contrary intention appears, warrants: (1) that the bill is genuine; (2) that he has a legal right to transfer it; (3) that he has knowledge of no fact which would impair the validity or the worth of the bill; and (4) that he has a right to transfer the title to the goods, and that the goods are merchantable or fit for a particular purpose whenever such warranties would have been implied if the contract of the parties had been to transfer without a bill the goods represented thereby.[20]

QUESTIONS

1. "The establishment and continued existence of huge enterprises of modern times depend largely upon transportation agencies." What is meant by this statement?

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[18] §32.
[19] §38.
[20] §35.

2. Gordy, who is making a canoe trip, is stopped by a farmer standing on the bank of the river. The latter delivers to Gordy a crate of eggs and asks him if he will take them to a specified person in the village which is located approximately a mile down the stream. Gordy agrees to make the delivery for fifty cents. Is he a carrier?

3. Hartzell, who lives in a small village, drives a wagon daily to the railroad station for the purpose of watching the trains arrive and depart. Occasionally he takes a traveling salesman's trunk to the hotel. For these services he receives pay. Is Hartzell a common carrier?

4. A railroad company entered into a contract with the owner of a circus, agreeing for a stipulated sum to transport twenty wagons from one city to another. Later the owner remembered that a rolling kitchen had not been included in the agreement. The company, when informed of this oversight, agreed to carry the rolling kitchen free of charge. Was the company, as to this article, a common carrier?

5. On January 27, a steamship company entered into an agreement with Ney to receive ten automobiles on February 10 at San Francisco and to deliver them to Honolulu. Was the relation of shipper and carrier established?

6. Camalier informs a carrier that he has four boxes of goods in his truck ready for shipment. He is directed by the carrier to take the boxes to the receiving station, which is open from eight o'clock in the morning until six o'clock in the evening. Wishing to visit with a friend, Camalier places his boxes outside the building near the door and hurries away. One of the boxes is stolen. Camalier brings an action against the carrier to recover for the loss. Is he entitled to judgment?

7. Weinitz, who intends to ship ten horses, drives them into a carrier's stock pen. He then goes to another part of the city to purchase several pieces of machinery for his farm. While he is absent, one of the horses escapes. Weinitz brings an action against the carrier to recover for the loss of the animal. Is he entitled to judgment?

8. A carrier issues a bill of lading acknowledging receipt of a box of goods. The agent notes on the bill of lading that the weight, value, contents, and quantity of the goods are unknown. The shipper transfers the bill of lading to a bona fide purchaser. When the goods are found not to be the same as described in the bill of lading, the latter brings an action for damages against the carrier. Is the carrier liable?

9. An agent for a carrier issues a bill of lading acknowledging receipt of ten barrels of apples. No goods, in fact, were delivered to the carrier. The bill of lading is transferred to a bona fide purchaser. Thereafter the purchaser of the bill of lading brings an action against the carrier for failure to deliver such goods. Is he entitled to judgment?

Part II—Duties of the Common Carrier

Receive and Transport Goods. A common carrier is, generally speaking, required to receive and carry the goods of all persons who offer them. The shipper is, of course, entitled to damages for the carrier's wrongful refusal to accept and carry goods, and he may in some cases secure a writ of injunction, restraining the carrier from wrongfully refusing to receive and to transport the goods offered.

Proper Goods. The duty of the carrier in this respect applies only to such goods as it holds itself out to carry. "At common law no person was a common carrier of any article unless he chose to be, and unless he held himself out as such; and he was a common carrier of just such articles as he chose to be, and no others. If he held himself out as a common carrier of silks and laces, the common law would not compel him to be a common carrier of agricultural implements, such as plows, harrows, etc." [1] Even when the carrier holds itself out generally to carry goods, it is under no duty to accept for transportation goods which are of an inherently dangerous nature, goods which are injurious to the public health, or goods which are contraband in the eyes of the law. For example, a carrier is under no duty to accept for shipment the meat of wild animals when such transportation is a violation of the game laws.[2]

> A carrier improperly refusing to receive and transport a quantity of "berry crates" was held liable not only for the amount of the actual damages but also for a statutory penalty of $50 for each day. (Corbett v. Atlantic Coast Line R. Co., 205 N. C. 85, 170 S. E. 129)

Excuses for Refusal to Receive. In some instances the carrier is excused from its failure to receive for carriage goods which it holds out to carry. Thus it is under no duty to accept for shipment goods offered at an improper time or place, or goods imperfectly packed.[3] It is also justified in

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[1] *Kansas Pac. Ry. Co.* v. *Nichols*, 9 Kans. 235.
[2] *Deitrich* v. *Fargo*, 52 Misc. Rep. 200, 102 N. Y. S. 720.
[3] *Post*, p. 530.

refusing goods when, because of military activities or because of some unforeseen emergency, it cannot within any reasonable time ship them. To illustrate, when a cotton crop exceeds all estimates and overtaxes the facilities of carriers, goods over and beyond the amount ordinarily shipped may be refused temporarily.[4] The carrier is also excused for failure to receive goods when the goods would be exposed to loss by extraordinary dangers. Thus, if goods would be exposed to loss by hostile military forces, mobs, or floods, the carrier is justified in refusing to accept them.[5]

Furnish Facilities. The carrier is under a duty to furnish adequate facilities necessary in the transportation of freight in the usual course of business.

Place of Receipt and Delivery. It is the duty of the carrier to furnish proper storage facilities for goods awaiting shipment or awaiting delivery after shipment. This duty in connection with the shipment of livestock requires the establishment of sufficient, suitable, and conveniently located pens or yards. Thus the carrier is liable for damages arising out of the fact that the pens furnished did not permit the watering of animals, or for damages resulting from the escape of animals due to the defective condition of the pens.[6]

> When at place of delivery a carrier had a stock pen too small for ordinary shipments, it was liable for injuries resulting from overcrowding. (Midland Valley R. Co. v. Price, 127 Okla. 106, 260 P. 26)

Cars. If the carrier is a railroad, it must furnish on the demand of a shipper sufficient cars to transport goods which are ready for shipment. "Except in cases of extraordinary and unusual emergencies which cannot reasonably be anticipated, it is the duty of railroad companies to equip themselves with sufficient cars to supply the demands for shipment, both interstate and intrastate, and a failure to furnish all cars demanded under other circumstances will not be ex-

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[4] *Yazoo & Miss. Valley R. R. Co.* v. *Blum*, 89 Miss. 242, 42 S. 282.
[5] *Illinois Central R. R. Co.* v. *McClellan*, 54 Ill. 58.
[6] *Oliver* v. *Chicago, etc., Ry. Co.*, 89 Ark. 466, 117 S. W. 238.

cused." [7] In addition to furnishing sufficient cars, the carrier must furnish cars which are suitable for carrying the various types of goods which the carrier professes to receive for transportation. Under this rule the carrier may be required, according to the circumstances, to furnish open, ventilated, or refrigerated cars. In carrying stock, it must furnish cars which are safe as well as suitable for such shipments.

> A railroad failed in its obligation to furnish proper facilities when the equipment furnished "was without the necessary permanent false floors which were shown to be reasonably necessary to insure safe transportation of celery in a refrigerator car." (Atlantic Coast Line R. Co. v. Chase & Co., 109 Fla. 50, 146 S. 658)

The carrier is not in default in its duty to furnish proper facilities, until the shipper has given reasonable and proper notice of his needs. This notice should state clearly the wants of the shipper; it should be timely; and it should be given to the proper agent. "To be reasonable, notice for such purpose must allow sufficient time to enable the railway company, by the exercise of reasonable diligence under the existing circumstances, to furnish the cars, without interference with orders previously given by other shippers at the same station, or jeopardy to its other business on other portions of the line." [8]

Proper Shipment. The carrier is under a duty to follow shipping directions furnished it. For its failure to do so, it is liable to the shipper for any loss or damage caused him. To illustrate, if the shipper directs that a crate be carried flat on the broad side, or if he directs that a certain side be kept up, the carrier is liable for any loss resulting from the disobedience of these instructions.[9]

Routing. In general the shipper has the right to select the route for shipment. The carrier is liable for any loss due to a failure to follow specific instructions. When the shipment is beyond the line of the initial carrier, "the shipper has the undoubted right to designate over what connecting

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[7] *Mason* v. *Mo. Pac. Ry. Co.*, 25 Mo. A. 473.
[8] *McNeer* v. *Chesapeake, etc., Ry. Co.*, 76 W. Va. 803, 86 S. E. 887.
[9] *Hastings* v. *Pepper*, 11 Pick. (Mass.) 41.

line his goods shall be shipped, and the first carrier is bound to obey instructions in this respect, and, if he disobeys them, he is liable as for a conversion." [10]

> A shipment of horses was misrouted by the carrier over the line of a railroad, contrary to the instructions of the shipper. The carrier was liable "for such loss as occurred by reason thereof." (St. Louis, B. & M. Ry. Co. v. Murray [Tex. Civ. A.], 40 S. W. [2d] 949)

When no special directions have been given, the carrier may send the goods by the route usually employed by it in shipping goods to that particular destination, unless the use of such a route would be disadvantageous to the shipper. If the carrier selects from the customary routes one which it knows to be longer, obstructed, or more dangerous to the goods, it is responsible for delays or injuries caused thereby. Thus the carrier is answerable for the loss caused to fruit by shipping it over a cold route when it might have shipped the fruit over a warm route.[11]

> In the absence of agreement, "the carrier was not bound to transport a carload of peony buds by any particular train, or otherwise than with reasonable dispatch." (Johnston v. Chicago & N. W. Ry. Co., 210 Wis. 227, 246 N. W. 336)

Care of Goods. The carrier is under a duty to protect the freight from loss or injury during transit. For example, it is liable for losses caused by failure to refrigerate cars in which goods requiring refrigeration are being shipped.[12] The rule is also applied to shipments of livestock. The carrier is answerable for damage caused to the animals by violent movements of the train. It must exercise care to prevent their escape. The duty of providing rest, as well as feed and water, to animals in transit falls upon the carrier in the absence of an agreement to the contrary.

> When the shipper did not accompany a hog shipment, "the duty of seeing that these hogs were properly cared for, properly fed, and properly watered, rested upon the rail-

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[10] *Wiggin Ferry Co.* v. *Chicago, etc., R. R. Co.*, 128 Mo. 224, 27 S. W. 568.
[11] *Pierce* v. *So. Pac. Co.*, 120 Calif. 156, 47 P. 874.
[12] *New York, etc., R. R. Co.* v. *Cromwell*, 98 Va. 227, 35 S. E. 444.

road company." (Brower v. Chicago, R. I. & P. Ry. Co., 218 Iowa 317, 252 N. W. 755)

Loading and Unloading. Generally speaking, it is the duty of the carrier to load and unload goods delivered to it for shipment, although the shipper or consignee may by contract assume this duty. The usage of trade in some cases places the duty on the shipper or consignee. For example, it is customary for the consignee to unload bulky freight such as ore, grain, coal, and lumber when shipped in carload lots.[13]

Preference. A common carrier must serve all alike and without unreasonable discrimination. It cannot give one shipper better accommodations than another or refuse goods of one person and accept goods of another without just grounds. Nor can it, as a general rule, charge one person more than another for the same service. "A person having a public duty to discharge is undoubtedly bound to exercise such office for the equal benefit of all, and, therefore, to permit the common carrier to charge various prices, according to the person with whom he deals, for the same services, is to forget that he owes a duty to the community. . . . The law that forbids him to make any discrimination in favor of the goods of A over the goods of B, when the goods of both are tendered for carriage, must, it seems to me, necessarily forbid any discrimination with respect to the rate of pay for the carriage." [14]

A statute requiring rates to be based on distance, "was enacted to prevent unjust discrimination." (Hallett Const. Co. v. Foley Bros., 191 Minn. 335, 254 N. W. 435)

Reasonable Discrimination. The carrier has met its obligation when it provides substantially the same treatment for all persons under the same conditions. Circumstances may, however, be such as to justify a difference in the treatment of shippers. In this event the discrimination is not unjust or unreasonable. "The carrier may be able to carry freight over a long distance at a less sum than he could over a short distance. He may be able to carry a large quantity at a less rate than he could a smaller quantity. The facilities for

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[13] *Beaumont* v. *Phil., etc., R. R. Co.*, 38 Pa. Super. 224.
[14] *Messenger* v. *Penn. R. R. Co.*, 36 N. J. L. 407.

loading and unloading may be different in different places, and the expenses may be greater in some places than in others." [15] If the service or rates affect equally all persons in the same class, and if the classification is really based upon differences in conditions, there is no unjust discrimination. For example, a higher rate may be charged for the shipment of dynamite than for the shipment of brick.[16] In most states it is held that giving credit to one shipper and not to another is merely a waiver of a right to demand prepayment and is not an unjust discrimination.

Delivery. It is the duty of the carrier to deliver the goods to the consignee, except when custom or special agreement relieves it of this duty. "Delivery is not merely an incident to the contract of affreightment; it is essential to its discharge." [17] A wrongful refusal to make delivery or a delivery to the wrong person renders the carrier answerable in tort for conversion, as well as for a breach of contract.[18]

> "A delivery to the wrong person may be treated as a conversion of the property." (Atlantic Coast Line R. Co. v. Roe, 91 Fla. 762, 109 S. 205)

Place. Goods must be delivered at the usual place for delivery at the destination specified. At one time carriers by land were required to make personal delivery, but the rule has been changed in the case of railroads and special carriers. Other carriers are, however, still governed by the original rule. Thus express companies are ordinarily required to deliver goods to the place of business or to the home of the consignee.[19] The station or warehouse of railroads is the usual place of delivery of inanimate goods, except when delivery is made from the car. When delivery is to be made from a car, the car must be placed so as to be reasonably accessible to the consignee. Delivery at a place other than the usual place may be justified by usage or by special agreement.

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[15] *Root* v. *Long Island R. R. Co.*, 114 N. Y. 300, 21 N. E. 403.
[16] *North-Eastern R. R. Co.* v. *Reckitt*, 109 L. T. Rep. (N.S.) 327.
[17] *Kohn* v. *Packard*, 3 La. 224.
[18] *Uniform Bills of Lading Act*, §13.
[19] *Gulliver* v. *Adams Express Co.*, 38 Ill. 503.

At common law there is no duty upon railroad companies to "deliver freight upon a private siding or spur track." (Milford Quarry & Construction Co. v. Boston & M. R. R., 84 N. H. 407, 151 A. 336)

To Whom. The carrier is under a duty to deliver the goods to the person to whom they are consigned, or to a properly authorized agent. When goods are shipped under a negotiable bill of lading, the carrier is not safe in delivering the goods without obtaining possession of the bill properly indorsed.[20] Thus one court stated that "if the goods, by the terms of the bill of lading, are deliverable to the order of the shipper, the carrier should not deliver except upon the production of the bill of lading properly indorsed by the shipper; 'for this is notice to the carrier that the shipper intends to retain in his power the ultimate disposition of the goods.' "[21] The same rule applies when the bill of lading is made to the order of the consignee. When goods are shipped under a straight bill of lading, the carrier is justified in delivering to the consignee, unless notified to deliver to someone else.

QUESTIONS

1. A common carrier is engaged in transporting parcels by messenger. Armagnac brings a dog to the carrier's office and demands that it be carried to a specified address. On the carrier's refusal to deliver the dog, Armagnac brings an action for damages. Is he entitled to judgment?

2. The X Carrier Company is engaged in transporting general merchandise between New York and Chicago. Dowd delivers several containers filled with nitroglycerin at the carrier's receiving station. The company refuses to accept the goods for shipment. Dowd brings an action for damages. Is he entitled to judgment?

3. The receiving station of a carrier is open from 8 A.M. to 5:30 P.M. One day at 6 o'clock Lodge delivers at the station several articles of the kind of goods customarily transported by the carrier. The carrier refuses to accept them for shipment. Lodge brings an action against the carrier to recover damages. Is he entitled to judgment?

4. A carrier enters into a contract with a shipper to carry a specified quantity of butter during the month of July. The company

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[20] *Uniform Bills of Lading Act*, §14.

[21] *Arkansas So. Ry. Co.* v. *German Nat'l Bank*, 77 Ark. 482, 92 S. W. 522.

does not provide a refrigerator car for the transportation of the goods. The shipper brings an action to recover damages from the carrier. Is he entitled to judgment?

5. Simon delivers a horse to a carrier for shipment and directs that it be carried in a closed car. The carrier transports the horse in an open car, and the animal is injured by exposure to inclement weather. Simon brings an action against the carrier to recover for the loss. Is he entitled to judgment?

6. Jordanoff wishes to ship certain goods from New York to Des Moines. The goods are carried to Chicago by the X Company, which is directed to send the goods from Chicago to Des Moines over the Y lines. The goods are actually shipped out of Chicago over the Z lines and are lost en route. Jordanoff brings an action against the carrier to recover damages. Is he entitled to judgment?

7. Lane, of Los Angeles, delivers several boxes of tools to a carrier for transportation to Salt Lake City. When the goods arrive, the consignee is notified by the carrier to unload the boxes. He refuses to do so, alleging that unloading of the goods is a duty of the carrier. Do you agree?

8. A common carrier enters into a contract to carry certain goods for McAuliffe on credit. When Ames delivers similar goods to the carrier, prepayment of charges is demanded. Ames brings an action against the carrier, contending that the carrier is guilty of unjust discrimination. Do you agree with his contention?

9. Pryor consigns a rifle to Vooght at Boise, Idaho. The carrier delivers the article to Bunn. Pryor brings an action against the carrier to recover the value of the article. Is he entitled to judgment?

10. Gaines ships a package, consigned to himself. At the destination, the carrier wrongfully refuses to make delivery of the article. May Gaines sue the carrier in tort for conversion?

11. Gray is consignee of a carload of flour. He contends that at common law the carrier is under a duty to deliver the flour upon the private siding that extends to his warehouse. Do you agree with this contention?

12. Certain goods are shipped under a bill of lading calling for delivery to the order of the shipper. At the destination, the shipper, without presenting the bill of lading, requests delivery of the goods. Is the carrier justified in refusing the request?

Part III—Liabilities of the Carrier

Before Transportation. When goods that are not for immediate transportation have been delivered to the carrier, the liability of the carrier for any loss or injury is that of an ordinary bailee in a mutual-benefit bailment. This situation may arise when the shipper delivers goods to the carrier with express instructions to hold them until a certain time, or when the goods are delivered for immediate shipment, but the shipment is postponed at the request of the shipper. To illustrate, if the shipper places his stock in the carrier's pens to be held subject to his directions, the carrier is in the position of an ordinary bailee.[1] The situation may also arise when the goods are deposited with the carrier, but something must be done to prepare them for shipment. For example, the agreement may require prepayment of freight charges. In this event the carrier until paid is liable only as a warehouseman.[2] It is also generally held that when a delivery is made without shipping directions the carrier is liable only as a bailee. The rule may be applied in some instances even after transportation has commenced. To illustrate, when the seller exercises his right of stoppage in transitu, the carrier holds the goods during the stoppage as a warehouseman.[3]

During Transportation. When goods have been delivered to the carrier for immediate shipment, the liability of the carrier is practically absolute from then until the transit ceases. "He is liable not only for losses occasioned by secret theft or embezzlement, but for those inflicted by highway robbery, by the spoliation and outrages of mobs, rioters, and insurgents. The most resistless, destructive conflagration, if occasioned by human agency, without negligence whatever on the part of the carrier, will furnish no ground for exemption." [4] This rigorous liability is imposed as a matter of public policy. The fact that the carrier has absolute possession and control of the goods precludes the owner from protecting them during

[1] *Flint* v. *Boston, etc., R. R. Co.*, 73 N. H. 141, 59 A. 938.
[2] *St. Louis, etc., R. R. Co.* v. *Cavender*, 170 Ala. 601, 54 S. 54.
[3] *MacVeagh* v. *Atchison, etc., Ry. Co.*, 2 N. Mex. 205.
[4] *Chevalier* v. *Straham*, 2 Tex. 115.

transit and offers opportunity to the carrier to embezzle the goods or to collude with others in their loss or destruction. Since under the circumstances the shipper would have great difficulty in proving this fact, the law makes the carrier an insurer of the goods during their transit.

To the general rule that the carrier is an insurer, there are important exceptions. These exceptions, in the absence of the statute, fall into five general classes.

Act of God. The carrier is not liable for losses due to acts of God. There is considerable conflict as to what constitutes an act of God. It is usually said that " 'the act of God' and the operation of nature, unmixed with human agency or human negligence, are synonymous." [5] Courts, however, are not in harmony as to acts which are caused by human agency and acts which could have been avoided by reasonable foresight and care. Tornadoes, earthquakes, and extraordinary floods are generally held to be acts of God.[6]

> An unprecedented flood, though an act of God, is no defense, when the carrier could have moved car in which goods were injured "to higher ground, but neglected to do so." (St. Louis-San Francisco Ry. Co. v. Ozark White Lime Co., 177 Ark. 1018, 9 S. W. [2d] 17)

Public Enemy. The carrier is not liable for losses due to acts of a public enemy. Acts of a public enemy are confined to cases of piracy or military forces operating against the government. Thus injuries and losses due to mobs, rioters, and thieves do not arise out of the acts of public enemies.[7]

Nature of Goods. The carrier is not liable for a loss or injury resulting from the inherent nature of the goods. "When a man delivers fruit, vegetables, milk, butter, eggs, meat, fish, live animals, or other perishable property to a common carrier, his object is transportation and not insurance against the irresistible laws of nature." [8]

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[5] *Coosa River Steamboat Co.* v. *Barclay*, 30 Ala. 120.
[6] *Long* v. *Penn. R. R. Co.*, 147 Pa. 343, 23 A. 459.
[7] *Missouri Pac. Ry. Co.* v. *Nevill*, 60 Ark. 375, 30 S. W. 425.
[8] *Rixford* v. *Smith*, 52 N. H. 355.

> The carrier was not liable when in a shipment "the corn heated because of some defect inherent in it, not because of some extraneous circumstance which with diligence the carrier could have averted, nor because of any incident or mishap which befell the corn in transit." (Parker Corn Co. v. Chicago, B. & Q. R. Co., 120 Kans. 484, 244 P. 240)

Acts of Shipper. The carrier is not liable for an injury caused by the act of the shipper; nor is the carrier responsible for a loss resulting from improper packing by the shipper. Some courts, however, do not apply the latter rule if the carrier knows or should know of the defective packing. The carrier is in part relieved of its extraordinary liability if the shipper fraudulently conceals the value of the goods. In this event the shipper has not only obtained the contract by fraud, but has also led the carrier into relaxing its vigilance. Almost all courts accordingly permit the shipper to recover only the apparent value of the goods, and not their actual value. Some courts hold the carrier liable merely as an ordinary bailee, whereas others completely relieve it from liability.

Public Authority. The carrier is not liable for goods taken from it by public authority under legal process or under process apparently legal on its face. For example, if the state seizes goods which were sold contrary to law, the carrier is not responsible for the loss.[9]

After Transportation. The goods must often remain in the custody of the carrier for some time after arrival at the destination. If delivery by the carrier is not required, what is its liability during this time? Three distinct rules have been developed in answer to this question.

Massachusetts Rule. Several courts follow what is known as the Massachusetts rule, which states that the carrier's liability as an insurer ends when the goods are safely stored for delivery at the destination. "If, for any reason, the consignee is not there ready to receive them, it is the duty of the company to store them and preserve them safely, under the charge of competent and careful servants, ready to be delivered, and

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[9] *Baltimore, etc., R. R. Co.* v. *O'Donnell,* 49 Ohio St. 489, 32 N. E. 476.

actually to deliver them when duly called for by the parties authorized and entitled to receive them. For the performance of these duties after the goods are delivered from the cars, the company is liable as a warehouseman, or keeper of goods for hire." [10]

New Hampshire Rule. A few courts hold that the liability of the carrier as an insurer continues after arrival of the goods at the destination until the consignee has had a reasonable time in which to remove them. They feel that "it is unreasonable to compel him [the consignee] to remain at the depot of the carrier awaiting the arrival of the goods, or to assume all the risks of the uncertainties in the delay or transportation and time of arrival"; [11] and that because the goods are still under the absolute control of the carrier, "the same necessity exists for encouraging the fidelity and stimulating the care and diligence of those who thus continue to retain them in charge, by holding that they shall continue subject to the risk." [12]

Federal Rule. The general rule, however, either by decisions of courts or by statute, is that the liability of the carrier as an insurer does not cease until the expiration of a reasonable time after notice has been given of the arrival of the goods. This rule differs from the preceding rule in that the reasonable period for the removal of goods starts at the time of notice instead of at the time of the arrival of the goods. Notice may be dispensed with, or required when otherwise unnecessary, either by contract or by usage. Even when notice is required, the carrier is sometimes excused from giving notice. For example, notice need not be given when the consignee is unknown and cannot be found with reasonable diligence, or when the consignee actually knows of the arrival of the freight.[13]

For Delays. A carrier is liable for losses caused by its failure to deliver goods within a reasonable time. Thus,

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[10] *Norway Plain Co.* v. *Boston, etc., R. R. Co.*, 1 Gray (Mass.) 263.
[11] *Leavenworth, etc., R. R. Co.* v. *Maris*, 16 Kans. 333.
[12] *Moses* v. *Boston, etc., R. R. Co.*, 32 N. H. 523.
[13] *Normile* v. *Northern Pac. Ry. Co.*, 36 Wash. 21, 77 P. 1087.

the carrier is liable for losses arising from a fall in prices or a deterioration of the goods, caused by its unreasonable delay.[14] The carrier does not, however, insure against delay. The law merely requires the carrier to transport and deliver the goods within a reasonable time. Risks of ordinary delays, incidental to the business of transporting goods, are assumed by the shipper.

> "The basis of liability for delayed transportation by rail is negligence." (Stephens v. Chicago & N. W. Ry. Co., 200 Wis. 181, 227 N. W. 875)

What is a reasonable time is a question of fact to be answered in view of the circumstances in each case. The carrier is not liable for loss due to delay, if it has exercised reasonable care and diligence in forwarding the goods. Unavoidable misfortune or accident, although not an act of God, may excuse the carrier from losses caused by delay. For example, loss resulting from a delay, caused by the washout of a bridge, by an unusually large amount of business, or by a heavy snowstorm, may be excused.[15] In some cases the carrier is under a duty to delay the shipment of goods, as when there are known dangers to which the goods would be exposed if sent more quickly. When the cause excusing the delay has ceased to operate, the carrier must deliver the goods within a reasonable time thereafter.

> An unusual press of business will excuse delay, for "to require carriers to be prepared at all times to handle with promptness an extraordinary amount of business would be to place upon them an intolerable burden." (L. J. Upton & Co. v. Atlantic Coast Line R. Co., 146 Va. 475, 131 S. E. 827)

A mere failure to deliver the goods within a reasonable time is not a conversion, although an inexcusable delay is an actionable wrong. In some instances the carrier is liable for special damages. Such is the case when it delays a given order known to be for a purpose which will be defeated by delay. Notice of such purpose may under some circumstances be implied. For example, the carrier is presumed to know

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[14] *Scovill* v. *Griffith*, 12 N. Y. 509.
[15] *Palmer* v. *Atchison, etc., R. R. Co.*, 101 Calif. 187, 35 P. 630.

that the purpose of a machine consigned during the harvest season will be defeated by delivery after the season has closed.[16]

Limiting Liability. It is generally held, in the absence of constitutional or statutory provisions to the contrary, that a carrier has the right to limit its liability by contract. Although the liabilities discussed are imposed by law, courts feel that under present conditions the shipper and carrier should within reasonable limits be permitted to make their own shipping arrangements as they see fit.

Risks. Almost all states permit the carrier by contract to relieve itself from liability from all losses except those arising out of its negligence. For example, an agreement that no liability arises when injury or loss is due to robbers, mobs, strikes, riots, or fires is valid.[17] These agreements, however, must be just and reasonable, and not contrary to public policy. In most states courts will not enforce a contract under which the carrier attempts to exempt itself from liability for loss or damage arising out of its negligence.[18]

> A bargain for exemption from liability arising out of negligence is illegal by a party owing a duty of public service, when such bargain "relates to negligence in the performance of any part of its duty to the public." (Restatement, Contracts, Sec. 575-1-b)

Amount. Almost all states permit the carrier to place a reasonable limit upon the amount of its liability for loss or damage to goods. An agreement providing for an unreasonably low value is contrary to public policy. To illustrate, the shipper was not bound by an agreement to limit the carrier's liability to the sum of five dollars a hundred pounds, which amounted to a liability of $77, when household goods worth

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[16] *Mo. Pac. Ry. Co.* v. *Peru-Van Zandt Implement Co.*, 73 Kans. 295, 85 P. 408.

[17] *Constable* v. *National Steamship Co.*, 154 U. S. 51, 38 L. Ed. 903.

[18] The Uniform Bills of Lading Act prohibits any term in a bill of lading that impairs the carrier's "obligation to exercise at least that degree of care in the transportation and safe-keeping of the goods entrusted to him which a reasonably careful man would exercise in regard to similar goods of his own." §3.

$782.67 were carried.[19] Some courts hold that a large variance between the agreed and actual value is against public policy, whereas others do not. Most states hold that the shipper is bound by any valuation to which he agrees or in which he acquiesces. Others hold that when the shipper assents, in the bill of lading, to a general limitation as to value set forth, the agreement is an "arbitrary preadjustment of the measure of damages," and is not binding.

> It is not illegal for a common carrier to make a bargain "limiting to a reasonable agreed valuation the amount of damages recoverable for injury to property by a non-wilful breach of duty." (Restatement, Contracts, Sec. 575-2)

Almost all the questions about limitations of carrier's liability are now the subject of much state and Federal legislation. Thus some states forbid the carrier to limit its contract to common-law liability.[20] These statutes, however, apply only to intrastate shipments; Federal statutes govern interstate shipments.[21]

QUESTIONS

1. Klenke delivered goods to a carrier for shipment and stated that shipping directions would be furnished on the next day. On the following day he gave the shipping directions to the carrier. In the meanwhile, however, the goods had been destroyed by fire. Klenke brought an action for damages against the carrier. The latter proved that it had exercised ordinary diligence in protecting the goods. Was this a valid defense?

2. The goods of Deerhake disappeared somewhere between the point of shipment and the destination. The carrier disclaimed liability for the loss on the ground that they were stolen by thieves. Deerhake brought an action for damages. Was he entitled to recover?

3. Goff goes hunting during the closed season and kills a large deer. He takes the antlers and part of the meat to the nearest village and ships the goods to his home. During transportation the game warden intercepts and seizes the shipment. Goff brings an action against the carrier to recover for the loss. Is he entitled to judgment?

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[19] *Hanson* v. *Great Northern Ry. Co.*, 18 N. Dak. 324, 121 N. W. 78.
[20] *Gulf, etc., Ry. Co.* v. *Trawick*, 68 Tex. 314, 4 S. W. 567.
[21] See the Federal Bills of Lading Act, 39 Statutes at Large 1916, Chapter 415.

4. Waite moved to a different city and accompanied his household goods while they were being carried by the X Company. During transportation Waite kicked over a lantern, thus setting fire to the car. His goods were totally destroyed. Waite brought an action against the X Company to recover for the loss. Was he entitled to judgment?

5. Parker in San Francisco shipped a car of tea to New York. As the train was approaching the outskirts of the city, it was derailed when an earthquake caused a building to fall upon the train. Some of the cars, including the one containing Parker's tea, were destroyed by fire. Parker brought an action against the carrier to recover for the loss. Was he entitled to judgment?

6. Seymour shipped his household goods to a city in which he expected to make his home. The goods arrived at their destination, were unloaded, and were stored for delivery. Five days later the goods were stolen. Seymour brought an action against the carrier to recover for the loss. Was he entitled to judgment?

7. McDermott shipped a car of melons to the market. The transportation was normally completed in two days. This time, however, the melons did not arrive until after three days had elapsed. The market price on the day preceding the arrival of the goods was much higher than on the day of arrival. McDermott brought an action for damages against the carrier. The carrier proved that it had exercised reasonable care and diligence in forwarding the goods. Was McDermott entitled to judgment?

8. Tavener shipped a box containing magician's paraphernalia to a city where he was billed to give a public performance. The carrier failed to deliver the goods within a reasonable time, and Tavener was unable to appear as scheduled. Tavener sued the carrier for special damages. Was he entitled to judgment?

9. Guilder entered into a contract of carriage with the L Company. The terms of the agreement provided that the carrier would not be liable in case the goods were destroyed by robbers, mobs, negligence of the carrier's servants, strikes, or riots. The goods were destroyed as the result of negligence on the part of certain employees of the carrier. Guilder brought an action against the carrier to recover for the loss. Was he entitled to judgment?

10. Cravet was the consignor of certain merchandise. An agreement was executed by him and the carrier, placing a reasonable limit upon the amount of the carrier's liability for nonwillful loss or damage to the goods. Was this agreement binding upon Cravet?

Part IV—Rights of the Common Carrier

Rules and Regulations. A carrier has the right to make reasonable and necessary rules for the management of its business. It may prescribe reasonable rules as to the packing and loading of freight so that it may be handled easily, swiftly, and securely. Thus a carrier may require the shipper to crate or box containers of liquids.[1] It may prescribe rules as to the time, place, and manner of delivering goods for shipment. To illustrate, a carrier may designate a particular warehouse or siding to which goods in bulk must be delivered for loading in the cars.[2] In all cases, however, the regulations must be reasonable, and compliance with them must not place unusual burdens or expenses upon the shipper. These rules cannot be maintained if they constitute undue discrimination between shippers. The rules are not binding when they are waived or are not brought to the attention of the consignor. For example, when it was a rule or custom of the company that agreements in respect to freight charges applicable to a particular kind of goods expired at the end of a year, the court held that "if such a custom existed, it could not be claimed to bind those who had no knowledge of it, nor could it be held to bind anyone if waived by the party making the rule." [3]

Compensation. The carrier has, of course, the right to demand reasonable remuneration for its services. This includes reasonable charges for services incidental to the carriage as well as for the carriage itself. For example, the carrier is entitled to reasonable compensation for sidetrack, storage, or terminal facilities and for switching and reassignment.[4] The carrier cannot, however, charge for services which were made necessary through its fault.

The person who consigns goods for shipment is ordinarily liable for the carriage charges. "The shipper or consignor,

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[1] *Vicksburg, etc., Tobacco Co.* v. *U. S. Express Co.*, 68 Miss. 149, 8 S. 332.
[2] *Robinson* v. *Baltimore, etc., R. R. Co.*, 129 F. 753.
[3] *A. & N. R. R. Co.* v. *Miller*, 16 Nebr. 661, 21 N. W. 451.
[4] *Yazoo, etc., R. R. Co.* v. *Searles*, 85 Miss. 520, 37 S. 939.

whether the owner of the goods or not, is the party with whom the owner or master enters into the contract of affreightment. It is he who makes the bailment of the goods to be carried, and, as the bailor, he is liable for the compensation to be paid therefor." [5] The carrier is entitled to prepayment of its charges, but it may, of course, waive the right.

> A mistake of a carrier in issuing a "prepaid" bill of lading "does not estop it from demanding payment of the lawful charges." (Central Warehouse Co. v. Chicago, R. I. & P. Ry. Co., 20 F. [2d] 828)

The consignee, in the absence of agreement to the contrary, is, generally speaking, not liable for the payment of freight charges. His promise to pay them may, however, be implied if he receives goods from the carrier knowing that he is expected to pay the charges. To illustrate, when the bill of lading states that the consignee is to pay the freight charges, the consignee's acceptance of the goods is strong, if not conclusive, evidence of a promise to pay them.[6]

Rates. Under the common law the common carrier has the power to establish its rates for transportation. The power is subject to the limitation imposed by law that the rates shall be just, reasonable, and not unfairly discriminatory. It is, however, within the power of the various states to prescribe reasonable rates for intrastate shipments. The state legislatures may, and usually do, delegate the power of rate-making to a commission.

> Under some statutes the commission may only supervise the rates initiated by the carriers; whereas under other statutes, as in Florida, the commission initiates the rates. (Louisville & Nashville R. Co. v. Speed-Parker, 103 Fla. 439, 137 S. 724)

So far as interstate commerce is concerned, Congress has the power to prescribe rates. Pursuant to this power, Congress has created an agency, known as the Interstate Commerce Commission, which is authorized to regulate rates for

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[5] *Wooster* v. *Tarr*, 8 Allen (Mass.) 270.
[6] *Pennsylvania R. R. Co.* v. *Titus*, 216 N. Y. 17, 109 N. E. 857.

interstate commerce.[7] This body carefully controls the rates which are charged by interstate carriers. It should be remembered, however, that the rates prescribed by the legislative branch of the government or by a commission are not final. The reasonableness of a rate is always subject to judicial review.

What Are Reasonable Rates. What constitutes a reasonable rate is a most perplexing question. A reasonable rate, it is usually conceded, is one which is a fair charge for the service rendered. This, however, does not solve the problem, for the question immediately arises, what is a fair charge for a given service? In determining what is a fair return for a particular service, there is considerable difference of opinion as to what factors should be considered and how they should be weighed. In an early case the United States Supreme Court states: "In order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property." [8] The method suggested has been severely criticized, and the question is as yet unsettled.[9]

Demurrage. In addition to, and distinct from, the right to charge for transportation, the carrier is entitled to make reasonable charges for the detention of its cars in which goods are shipped. This is known as the right to make a *demurrage* charge. The term *demurrage* is derived from the maritime law which allows charges for unreasonable detention of vessels. The object of demurrage charges is not only to

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[7] *Mason's United States Code, 1926*, Title 49, ch. 1, §4.
[8] *Smyth* v. *Ames*, 169 U. S. 466.
[9] Dissenting opinion of Justice Brandeis, *State of Missouri* v. *Public Service Commission*, 262 U. S. 276, 67 L. Ed. 981.

compensate the carrier for its services, but also, in the interest of the general public, to expedite the movement of cars. "If a road cannot make a reasonable charge for detention of its cars by consignees, it is evident that such consignees may delay unloading until virtually the entire rolling stock of the road may be tied up, and its tracks obstructed by loaded cars, awaiting the pleasure or convenience of consignees." [10]

> It was held that the "free time" for unloading as provided by law was extended when unloading by consignee was delayed by an uprising, known as the "Armed March," which had to be quelled by United States troops. (Chesapeake & O. Ry. Co. v. Board, 100 W. Va. 222, 130 S. E. 524)

The right to demurrage may exist either by statute or by express contract. In any event, however, most states allow a carrier a reasonable charge for the detention of cars. In some states the consignee is not obligated to pay demurrage unless he has knowledge of the demurrage rules. In all states the rules must be reasonable as to the time allowed for unloading and as to the sum fixed for detention beyond that period; and the rules must apply to all shippers alike.

> The twenty-four hours' "free time" as allowed by law was held to be extended when delay in unloading was due to fault of carrier in sending notice of arrival to an improper address. (Milne Lumber Co. v. Michigan Central R. Co. [Mo. A.], 57 S. W. [2d] 732)

The consignee is ordinarily chargeable with demurrage. In some instances, however, the consignor must pay them. For example, if the consignee refuses to accept goods and the carrier gives proper notice of the fact to the consignor, the latter, in the absence of agreement to the contrary, is liable for charges accruing thereafter.[11] The consignee, generally speaking, is not excused from liability for demurrage merely because he is unable sooner to free the cars. He is excused, however, if the delay is wrongfully caused by the carrier. To illustrate, if the carrier will not permit the consignee to un-

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[10] *Swan* v. *Louisville, etc., R. R. Co.*, 106 Tenn. 229, 61 S. W. 57.
[11] *Baltimore, etc., R. R. Co.* v. *Luella Coal Co.*, 74 W. Va. 289, 81 S. E. 1044.

load until he has paid charges which are excessive, the consignee is not liable for demurrage.[12]

Lien. A common carrier has a lien on goods which it transports as security for unpaid transportation charges. The essence of the lien is the carrier's right to retain possession of the goods until the charges are paid. The lien also secures the payment of charges for all incidental expenses incurred in the transportation of the goods. To illustrate, if charges may be made for storage, the lien of the carrier covers such charges.[13] The various states are divided on the question whether the carrier's lien covers demurrage charges. By statute, contract, or usage, however, the carrier's lien may secure such charges.[14]

> When a well-drilling outfit was held by a carrier under a lien for charges, "the consignee had no right to take it until this was paid." (Brown v. State, 167 Tex. Cr. R. 557, 298 S. W. 907)

The lien of a carrier is a specific, and not a general, lien. It attaches only to goods shipped under the particular contract, but includes all the shipment although sent in installments. In other words, when part is delivered, the lien attaches to the portion remaining in possession of the carrier. As a general rule, the lien of the carrier has priority over claims of other persons. It is, for example, superior to the claims of general creditors or of attaching creditors.[15] In a few instances, however, the claim of a creditor is superior to the lien of the carrier.[16] For example, a mortgagee has a prior claim if the carrier has proper notice of the mortgage.[17]

When the carrier extends credit for its charges for transportation, it thereby waives its lien for charges. The carrier surrenders its lien if it voluntarily surrenders possession of the goods to the consignee, if it refuses a valid tender of charges, or if it demands excessive charges.

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[12] *Louisville, etc., R. R. Co.* v. *Empire State Chem. Co.*, 189 F. 174.
[13] *Illinois Cent. Ry. Co.* v. *Alexander*, 20 Ill. 23.
[14] *Uniform Bills of Lading Act*, §26; *Federal Bills of Lading Act*, §25.
[15] *Campbell* v. *Conner*, 70 N. Y. 424.
[16] *Uniform Bills of Lading Act*, §43; *Federal Bills of Lading Act*, §40.
[17] *Owen* v. *Burlington, etc., R. R. Co.*, 11 S. Dak. 153, 76 N. W. 302.

A carrier waived its right to a lien by delivery of trucks to the consignee. "Once waived, the right is not restored, even though the goods again come into possession of the carrier." (Madden Bros. v. Jacobs, 204 Wis. 376, 235 N. W. 780)

The carrier is not, as against the owner, entitled to a lien on goods which are delivered to it for transportation without the owner's express or implied consent. This rule may at first seem harsh, since the carrier is bound to receive goods for carriage. He is not, however, "bound to receive goods from a wrong-doer. He is bound to receive goods only from one who may rightfully deliver them to him, and he can look to the title, as well as persons in other pursuits and situations of life. Nor is a carrier bound to receive goods unless the freight or pay for carriage is first paid to him; and he may in all cases secure payment of the carriage in advance." [18] The carrier, of course, has a lien on the goods as against the person actually shipping them.

QUESTIONS

1. A common carrier announced that it would receive and accept freight any time between the hours of 8:00 A.M. and 5:00 P.M. Marshall contended that the carrier was bound to receive and accept for shipment goods which were brought before sundown and that the rule as announced could not be enforced. Do you agree?

2. Heston delivered certain goods to a carrier one hour after the time that the carrier had announced that it would receive and accept the goods. The goods were, however, accepted by the carrier. During the night the goods were destroyed. Would the carrier have any responsibility as to the goods in view of the rule that had been announced as to receipt and acceptance of freight?

3. Kilduff, who is moving to another city, ships his household goods. The compensation demanded by the carrier includes, in addition to the charges for service in connection with the carriage, a charge for switching. Kilduff refuses to pay the additional charge. Is his refusal justified?

4. Shafton consigns a refrigerator for shipment. Later the carrier demands the freight charges from the consignee who refuses to pay them. The carrier brings an action against the consignee to recover the amount. Is it entitled to judgment?

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[18] *Robinson* v. *Baker*, 5 Cushing (Mass.) 137.

5. Tilden delivers certain goods to a carrier for shipment. When informed of the rates for carrying goods of the kind which he desires to send, he enters a violent protest alleging that the rates are much too high. He is advised by a clerk in the office that a common carrier can charge any rate it wishes. Do you agree?

6. A state utilities commission was empowered by the legislature to prescribe rates for intrastate shipments. When the commission published a schedule of rates, the carriers filed a protest alleging that the rates were too low. The shippers considered the rates too high, but did not enter a protest because they were advised that the reasonableness of the rates as established by the commission was conclusive. Had the shippers been correctly advised?

7. Logan consigns two cars of coal to Moiszner. The latter refuses to accept the goods, and Logan is promptly notified of this fact by the carrier. Several days later Logan directs the carrier to return the coal. The compensation demanded by the carrier includes a demurrage charge which Logan refuses to pay. Is Logan chargeable with the demurrage?

8. Rankin protests against the compensation demanded by a carrier. He pays the charges in connection with the services of transportation and demands delivery of the goods. The carrier will not surrender the goods until Rankin has also paid a charge for terminal facilities. Rankin brings an action of replevin to recover the goods. Is he entitled to judgment?

9. Gleave received certain goods from a carrier without paying the charges. On the following day the carrier refused to deliver certain goods consigned to Gleave until Gleave paid charges that included the charges for the goods delivered on the preceding day. Gleave brought an action against the carrier to obtain possession of the goods without paying the charges on the first shipment. Was he entitled to judgment?

10. Orr steals an automobile from Pennington in Chicago and consigns it to himself in Buffalo. Pennington learns of the shipment and demands the car from the carrier at the point of destination. The company refuses to deliver the car until the charges for transportation are paid. Is the refusal of the company justified?

Part V—Public Carriers of Passengers

Receive and Transport Passengers. Common or public carriers of passengers are required in general to receive for carriage all persons on substantially the same terms and conditions. Thus a carrier, in the absence of a good cause, cannot sell tickets to some persons and not to others.[1] A carrier is not under a duty to carry passengers on freight trains, unless it holds itself out to carry passengers on these trains. Nor is one entitled to demand carriage on a special train.

> A person wrongfully refused transportation may recover not only additional cost and expense, "but also, under the sound discretion of the jury, actual damage for mental suffering and humiliation." (Louisville & N. R. Co. v. Frizzle, 21 Ala. A. 354, 108 S. 615)

The carrier is under a duty to carry only proper persons. It may refuse transportation to those who require more than the usual attention. For example, persons who are helplessly intoxicated, crippled, blind, or insane, and are without attendants, may justifiably be denied transportation.[2] The carrier is not required to carry persons who intend to harm the carrier or its passengers, or who are likely to be dangerous to the latter, as in the case of a person with smallpox. Nor must it carry persons who are likely to misconduct themselves. Thus one court stated that "a railroad company is not bound to receive any person as a passenger who is drunk to such a degree as to be disgusting, offensive, disagreeable, or annoying; and a person so drunk as to be likely to violate the common proprieties, civilities, and decencies of life has no right to a passage while in that condition." [3]

Passengers. The relation of carrier and passenger arises from an express or implied contract of carriage. A person who places himself within control of the carrier with the intention of receiving and paying for transportation is a *passenger*, even though he has not purchased a ticket. The

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[1] *State* v. *Delaware, etc., R. R. Co.*, 48 N. J. L. 55, 2 A. 803.
[2] *Ill. Cent. Ry. Co.* v. *Allen*, 121 Ky. 138, 89 S. W. 150.
[3] *Pittsburgh, etc., R. R. Co.* v. *Vandyne*, 57 Ind. 576.

fact that a person rides on a pass does not deprive him of the status of a passenger. For example, a person riding on a pass for which some form of consideration has been given is a passenger.[4] Persons, such as trespassers, defrauders, and tramps, who ride without the carrier's permission, are not passengers. A person may be a passenger before actually boarding the train. Thus a person may be a passenger while waiting on the premises of the carrier for a train which he intends to board.[5] Persons who, without the carrier's permission, ride on the engine or in the baggage cars are not entitled to protection and treatment as passengers.

> When a boy boarded a train for the purpose of stealing a ride, it was held that he was not a passenger. (Cotter v. Boston R. B. & L. R. Co., 258 Mass. 279, 154 N. E. 767)

The relation of carrier and passenger continues until terminated by the carrier on just grounds, by some voluntary act of the passenger, or by the completion of the journey. At his destination a person continues to be a passenger until he has had reasonable time and opportunity for leaving the conveyance and premises of the carrier. After the passenger's departure from the station grounds, or after the lapse of a reasonable time and opportunity for departure, the relation of carrier and passenger ends. The relation is suspended for the time being when the passenger leaves the train at other than appropriate stops.

Duties of the Carrier. The carrier is under a duty to carry passengers safely to the destination for which transportation was purchased, and it is liable for breach of contract for its failure to do so. It is under the further duty to stop at such a place except when, under reasonable rules and regulations, a particular train is not scheduled to stop at that station. A carrier is sometimes justified by exceptional conditions, such as a quarantine, in not stopping at scheduled points.

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[4] *Hedrick* v. *Mo. Pac. Ry. Co.*, 195 Mo. 104, 93 S. W. 268.
[5] *Fremont, E. & M. R. R. Co.* v. *Hazblad*, 72 Nebr. 773, 101 N. W. 1032.

A passenger boarded a train that did not stop at his destination. It was held that "a passenger before boarding a train should use due diligence to ascertain if it stops at his destination." (Shepherd v. Southern Ry. Co., 135 S. C. 75, 133 S. E. 231)

The carrier must give reasonable notice of the approach to a station, that passengers may have an opportunity to prepare to leave the train safely. Such notice does not require actual notice to each passenger. The carrier sufficiently performs its duty in this respect if it makes such general announcements as will come to persons of ordinary hearing. For example, the carrier is not liable to a person who because of deafness or because he is asleep does not hear the announcement of his destination.[6]

When the conductor announces a station, "the passenger is warranted in relying upon such announcement as being correct, unless he knows that the station is some other than the one actually called." (Belcher v. Atlantic Coast Line R. Co., 175 S. C. 9, 177 S. E. 890)

The carrier must exert reasonable diligence to arrive at various points approximately at scheduled times. In the absence of a special undertaking, a carrier does not guarantee that its trains will arrive on time. The carrier is liable, however, for unreasonable delays which result from its negligence. The carrier is under a duty to remain a reasonable time at each stop, so as to permit passengers to alight safely from the vehicle. It is also under a duty to stop at a place which is convenient and safe for alighting. In the absence of special circumstances, the carrier is under no duty to assist passengers in alighting. "In the case of a sick, old, or infirm passenger or one making request for assistance, it undoubtedly is the duty of the company to assist him, and in cases where by the use of ordinary care the conductor or other train employees see that such help is needed, it becomes the duty of the company to furnish such assistance." [7]

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[6] *Nichols* v. *Chicago, etc., Ry. Co.*, 90 Mich. 203, 51 N. W. 364.
[7] *St. Louis, etc., R. R. Co.* v. *Lee*, 37 Okla. 545, 132 P. 1072.

Rights of the Carrier. The carrier of passengers is entitled to reasonable compensation for its services. In the absence of statutory or constitutional provisions, it has the right to determine and fix the rates of charge for transportation. The rules governing the compensation of common carriers of goods are, in general, applicable to the compensation of carriers of persons.

The carrier is entitled, in the absence of statute, to make necessary rules and regulations governing its service. For example, the company as a matter of convenience and safety may require passengers to remain inside of cars while the conveyance is in motion.[8] The right to make rules and regulations must be exercised reasonably and without discrimination. Usually the posting of such rules in some conspicuous place is sufficient to charge passengers with notice of them.

> A rule not to permit any greater number of passengers to board a bus than there were seats, provided there was another bus going over the same route within a reasonable time, was held to be a reasonable rule and regulation. (Brumfield v. Consolidated Coach Corp., 240 Ky. 1, 40 S. W. [2d] 356)

The carrier may, under appropriate circumstances, eject passengers from its conveyance. A person who, after a reasonable time, refuses to pay the required fare or produce a ticket may be removed from the vehicle. A passenger who refuses to conform to the reasonable regulations of the carrier may be removed. To illustrate, the carrier may eject a passenger who refuses to comply with a regulation prohibiting the presence of dogs in a car for passengers.[9] In the absence of statute providing otherwise, a passenger who is subject to ejection may be removed from the train at any place provided his removal at a given place does not expose him to great peril. What constitutes peril, as the term is used in this connection, depends upon the weather, the place, and the physical condition of the person. Statutes in some states provide that carriers, in removing passengers for nonpayment of fare, shall exercise the right at the next station or at a

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[8] *Coombs* v. *Southern Wis. Ry. Co.*, 162 Wis. 111, 155 N. W. 922.
[9] *Gregory* v. *Chicago, etc., Ry. Co.*, 100 Iowa 345, 69 N. W. 532.

place near a dwelling house.[10] The carrier may use only reasonable force in the removal of a passenger, and it is answerable in damages if it employs more. The carrier is liable to a passenger for an injury caused him by removing him from a train traveling at a dangerous rate of speed. Indeed, in some states statutes require the carrier, before removing a passenger, to stop its train.

Liability for Personal Injuries. The carrier is not an insurer of the passenger's safety. "What the law does require is everything necessary to the security of passengers, consistent with the business of the carrier and the means of conveyance employed; the highest degree of care consistent with practical operation." [11] What constitutes "highest degree of care" or, as sometimes stated, "utmost care and prudence" is a question of fact frequently difficult to answer. "The 'highest degree' of care, skill, and diligence is a relative term, and means the highest degree required by law in any case where human life is at stake, and the highest degree known to the usage and practice of very careful, skillful, and diligent persons engaged in the business of carrying passengers by similar means and agencies." [12] The carrier is ordinarily held to this high degree of care only in connection with the equipment and operation of its trains. As to other matters, such as the condition of the station and premises, its duty is to exercise ordinary care under the circumstances.

> "The presence of a banana skin on the platform, without actual or constructive knowledge of that fact, would not impose liability" upon the carrier. (Deegan v. Pennsylvania R. Co., 307 Pa. 207, 160 A. 858)

The carrier, generally speaking, is not answerable for discomforts ordinarily incidental to travel. For example, the carrier is not liable to a passenger who is made ill by exposure caused by the opening of a window by another passenger.[13] The carrier is, of course, not liable to a passenger who suffers some injury as a result of his own lack of care. A carrier,

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[10] *McCook* v. *Northup*, 65 Ark. 225, 45 S. W. 547.
[11] *Campbell* v. *Duluth, etc., R. R. Co.*, 107 Minn. 358, 120 N. W. 375.
[12] *Birmingham, etc., Ry. Co.* v. *Barrett*, 179 Ala. 274, 60 S. 262.
[13] *Louisville, etc., R. R. Co.* v. *Fisher*, 155 F. 68.

after discovering the peril of a trespasser or licensee, must exercise due care for his safety. Beyond that it owes no duty of care to such persons.

Liability for Baggage. A carrier of passengers is required to receive a reasonable amount of baggage. His liability in this respect is the same as the liability of a carrier of goods. To illustrate, the carrier is liable for the loss of goods stolen from a trunk in possession of the carrier.[14] In case of an unusual amount of baggage, the carrier is entitled to make an extra charge. If the passenger retains custody of his baggage, the carrier is liable only for lack of reasonable care. When the carrier is transporting baggage gratuitously, it is liable only for gross negligence, or it is liable merely as a bailee in a bailment for the sole benefit of the bailor. The liability of the carrier continues until the passenger has had reasonable opportunity to remove the baggage. If it is not removed within a reasonable time, the carrier may charge for storage, and from then on it is liable merely as an ordinary bailee for hire.

> "It is well settled that a carrier's common-law liability as an insurer of baggage does not extend to the hand baggage carried by a passenger on his journey." (Posner v. New York Central R. Co., 154 Misc. 591, 277 N. Y. S. 671)

What Constitutes Baggage. It is frequently difficult to determine what constitutes baggage. It has been defined as "such articles of necessity or personal convenience as are usually carried by passengers for their personal use; and not merchandise or other valuables, although carried in the trunks of passengers, which are not designed for such use, but for other purposes, such as sale or the like."[15] Some courts limit the articles to what is necessary for the trip, but the term is generally held to embrace such as are needed for a reasonable time after the journey. Whether a particular article is necessary as to its character, quality, or quantity depends upon whether passengers under the same circumstances usually carry such articles for personal use when trav-

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[14] *Knieriem* v. *N. Y. Cent. R. R. Co.*, 109 App. Div. 709, 96 N. Y. S. 602.

[15] *Ill. Cent. Ry. Co.* v. *Mathews*, 114 Ky. 973, 72 S. W. 302.

eling. Thus an overcoat taken on a trip into a warm climate, or a lady's watch in a man's trunk, will not be considered baggage.[16]

QUESTIONS

1. Mark applied to a steamship company for passage from New York to Boston. The request for carriage was denied, and Mark brought an action for damages. The company proved that Mark was afflicted with smallpox at the time he applied for passage. Was Mark entitled to judgment?

2. A prominent businessman in St. Louis missed the last train leaving for Chicago on a certain day. Upon learning that the mail and express train was due to depart two hours later, he demanded carriage on this train. His demand being refused, he brought an action against the railroad company to recover damages. Was he entitled to judgment?

3. Toggins arrives at a railway station thirty-five minutes before his train is due. He checks his hand luggage, intending to leave the station for a short period. Shortly after checking the luggage, Toggins suffers an injury in the station. Toggins brings an action against the carrier, contending that he had been a passenger at the time of his injury. Do you agree with his contention?

4. Bradnick returns to college over the X line. He represents himself to be under fourteen years of age in order to secure a reduction in fare. An action is brought against the carrier to recover damages for an injury suffered during the trip. Bradnick contended that he was a passenger at the time of the injury. Was his contention sound?

5. The porter on a train announced the approach to a small village. Lardner, who was traveling to this village, failed to hear the announcement because of a serious defect in his hearing and was carried beyond his destination. Thereafter he brought an action against the carrier to recover damages. Was he entitled to judgment?

6. The Sunshine Special is a train due in New Orleans at 8:30 A.M. One morning it did not arrive until 10:00 A.M. One of the passengers had an important engagement in New Orleans at nine o'clock that morning. He brought an action for damages caused by the failure of the train to arrive on schedule time. Was the carrier liable?

7. The rules of a streetcar company required passengers to deposit the amount of their fares in an automatic collector. Rutgers boarded one of the cars but refused to comply with this rule. The carrier thereupon

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[16] *Metz* v. *Calif. So. R. R. Co.*, 85 Calif. 329, 24 P. 610.

ejected him from its conveyance. Rutgers brought an action for damages. Was he entitled to judgment?

8. Linn is injured in a wreck caused by a defective roadbed. In the trial of an action for damages the carrier proves that it exercised ordinary diligence in the care of the track. Is this a valid defense?

9. A passenger arrived on a late train one evening. While descending some steps in the station, he fell. He brought an action to recover damages for an injury, alleging that the station was not sufficiently lighted. The company proved that the station was sufficiently lighted for a reasonable time before and after the arrival of the train so as to provide reasonable safety to the passengers. Was this a valid defense?

10. Helger, while on a vacation trip, suffered the loss of a suit of clothes and a set of hair brushes. The suit was taken from his trunk which he had checked with the carrier. The hair brushes were removed from his handbag which he had left in his seat while he was on the observation platform. In an action brought by Helger against the carrier to recover for his loss, the carrier proved that it had exercised ordinary care in the protection of Helger's property. Was Helger entitled to judgment?

CASES FOR REVIEW

1. One evening B. E. Pedrick delivered to a carrier eight cars of cattle, containing about three hundred and forty-three head, for transportation between Belen and Willard, New Mexico. He said at the time that he wanted the cattle shipped the next morning so that they would arrive during the day. The carrier did not ship the cattle on a fast train that left around seven the next morning, but on a train that left at two in the afternoon and that arrived at Willard in the evening. Pedrick brought an action against the Southern Pacific Company to recover damages for delay. Was he entitled to judgment? (Pedrick v. Southern Pacific Co., 38 N. M. 284, 31 P. [2d] 705)

2. A. B. Brick purchased a ticket to ride on a train of the Atlantic Coast Line Railroad Company. The ticket was used by another person, who checked a trunk containing Brick's wearing apparel and jewelry that was to be sold in his store at Chadburne, North Carolina. The trunk was lost, despite the exercise of ordinary care on the part of the carrier to safeguard it. Brick brought an action against the Atlantic Coast Line Railroad Company to recover damages. Was he entitled to judgment? (Brick v. Atlantic Coast Line R. Co., 145 N. C. 203, 58 S. E. 1073)

3. Josh Owens was adjudged insane and committed to the State Sanatorium at Milledgeville, Georgia. He was attended by his brother and a friend, but he resisted being placed in a car of a train of the Macon & Birmingham Railroad Company. At the same time he began swearing loudly and stating that he would not be quiet. The general manager of the carrier, who happened to be on the train, gave instructions that Owens could not be carried on the train. Thereafter the brother, J. B. Owens, brought an action against the carrier to recover damages. Was he entitled to judgment? (Owens v. Macon & B. R. Co., 119 Ga. 230, 46 S. E. 87)

4. M. B. Guran and one Myers were engaged for compensation in hauling milk by truck from certain producers, members of the Summit County Milk Producers Association, to the White Rock Dairy Company, of Akron, Ohio. Melvin H. Hissem, who was also engaged in hauling milk from the same community to Akron, sought to restrain Guran and Myers from operating their truck because they had not been certified as common carriers by the Public Utilities Commission. He contended that they were engaged in the business of a common carrier. Do you agree? (Hissem v. Guran, 112 Ohio St. 59, 146 N. E. 808)

5. G. O. Shackleford delivered to the Seaboard Air Line Railroad at Athens, Georgia, a piece of machinery for transportation to Abbeville, Georgia, consigned to himself. The machinery was unloaded at its destination, and Shackleford was notified that it was ready for delivery and that storage charges would accrue after April 12. During the following November, Shackleford for the first time offered to pay the transportation charges, but he refused to pay the storage charges. Thereafter he brought an action against the carrier for refusal to deliver the goods without payment of the storage charges. Was he entitled to judgment? (Seaboard Air Line Ry. v. Shackleford, 5 Ga. A. 395, 63 S. E. 252)

6. Alexander L. Murphy, a passenger on a train of the Pere Marquette Railroad Company, alighted near a station for exercise. With his arm encumbered by carrying an umbrella, he attempted to board the train while it was in motion. He was thrown under the cars by being struck by a truck on the platform of the station. The administratrix of his estate, Catherine M. Murphy, brought an action against the carrier to recover damages. Was she entitled to judgment? (Murphy v. Pere Marquette R. Co., 183 Mich. 435, 150 N. W. 122)

7. Edward F. Slater delivered certain horses and mules to the South Carolina Railway Company at Atlanta, Georgia, for transportation. While the animals were in transit, an earthquake occurred that set loose the waters confined in a pond at Langley Mills at Horse Creek, Georgia. The waters swept away and destroyed the horses and the mules. Slater brought an action against the carrier to recover for the loss. Was he entitled to judgment? (Slater v. South Carolina Ry. Co., 29 S. C. 96, 6 S. E. 936)

8. Otto Roeske, under the name of U-Drive-It Car Company, was engaged in the business of letting passenger motor vehicles for hire. Under the rental agreement, he furnished no drivers and had no custody or control of such cars during the rental period. In an action brought by Roeske against J. D. Lamb, chairman of the state corporation commission, it was contended that the business of Roeske came under a statute regulating the business of carriers. Was this contention sound? (Roeske v. Lamb, 39 N. M. 111, 41 P. [2d] 522)

9. Cable & Shute pledged certain mules and horses to a creditor, Edwin Cooley, who was authorized to ship the animals from Deadwood, South Dakota, to St. Paul, Minnesota. When the animals arrived at their destination, the carrier refused to surrender them to Cooley until the transportation charges were paid. Cooley brought an action against the carrier to recover possession of the animals without paying the charges. Was he entitled to judgment? (Cooley v. Minnesota Transfer Ry. Co., 53 Minn. 327, 55 N. W. 141)

10. The Baltimore & Ohio Railroad Company made a regulation applicable to all mines during a period of car shortage because of unusual conditions. It assigned open-top cars to mines loading coal from tipples and box cars to mines loading coal from trucks and wagons. The mines with tipples could not use box cars, but could load open-top cars in a few minutes. The other class of mines had to use shovels to load either kind of car and could load an open-top car in about a day. It was contended that the foregoing regulation constituted undue discrimination. Do you agree? (Baltimore & O. R. Co. v. Public Service Comm., 81 W. Va. 457, 94 S. E. 545)

11. The city of Chicago, Illinois, enacted an ordinance prohibiting any person, firm, or corporation from transporting into the city milk that was of a temperature higher than fifty-five degrees. Thereafter the city brought an action against the Chicago & Northwestern Railway Company for violation of the ordinance. It was contended that the carrier was under a duty to accept cans of milk from shippers, although the temperature of such milk was over and could not during transit be reduced under the maximum set by the ordinance. Do you agree? (City of Chicago v. Chicago & N. W. Ry. Co., 275 Ill. 30, 113 N. E. 849)

12. The Pennsylvania Railroad Company delivered to the Midvale Steel Company, an iron and steel manufacturer in Nicetown, Pennsylvania, certain cars laden with iron, coal, and other products. The cars were not unloaded for several days. The carrier, in accordance with its regulations, made a charge of $1 a day for the time the cars were held over forty-eight hours, not including Sundays and holidays. The steel company refused to pay the charge, and the carrier brought an action to recover the amount. Was it entitled to judgment? (Pennsylvania R. Co. v. Midvale Steel Co., 201 Pa. 624, 51 A. 313)

13. Roscoe Hull boarded a train of the Boston & Maine Railroad to travel from Worcester, Massachusetts, to Charlestown, New Hamp-

shire. He carried a small dog, which he kept on his lap after being seated. The conductor told Hull a rule of the company required that the dog be placed in the baggage car. When Hull refused to comply with the rule, he was removed from the train at the next station. Was the carrier entitled to do this? (Hull v. Boston & M. R., 210 Mass. 159, 96 N. E. 58)

14. The Pennsylvania Railroad Company placed a car, at the request of the Standard Combed Thread Company, on a public siding some distance from its station, allowing the shipper forty-eight hours to load the car. Because the loading was completed, in less than forty-eight hours, at six in the evening after the freight office had closed, notice of the loading was not given to the carrier. During the night the contents of the car were destroyed by fire. The thread company brought an action against the railroad company to hold it liable as a carrier. Was the thread company entitled to judgment? (Standard Combed Thread Co. v. Pennsylvania R. Co., 88 N. J. L. 257, 95 A. 1002)

15. J. F. Utley, a dealer in hay and grain at Capac, Michigan, through his agent, O'Hara, consigned a carload of hay from Auburn, New York, to himself as consignee on a straight bill of lading. Thereafter he wrote a letter to the effect that the hay was to be delivered by the carrier to the Balme Company. The railroad company delivered the hay to the Balme Company. Because the hay had not been paid for, Utley brought an action against the carrier to recover damages for misdelivery. Was he entitled to judgment? (Utley v. Lehigh Valley R. Co., 292 Pa. 251, 141 A. 53)

16. Harry G. Young delivered to the Main Central Railroad Company a carload of potatoes for transportation from Hillside, Maine, to Summit, New Jersey. The carrier, by agreement with Young, limited its liability in that the shipper assumed all risk of loss by the freezing of the potatoes. As the result of negligence on the part of the carrier, the potatoes were damaged by freezing. Young brought an action against the carrier to recover damages. Was he entitled to judgment? (Young v. Maine Cent. R. Co., 113 Me. 113, 93 A. 48)

17. Frank Gardner, of St. Louis, Missouri, delivered a number of stoves to the New Orleans & Northeastern Railroad Company for transportation. The stoves were injured while in transit as the result of water during a rainstorm leaking through the roof of the car in which they were being transported. Gardner brought an action against the railroad company to recover damages. Was he entitled to judgment? (Gardner v. New Orleans & N. E. R. Co., 78 Miss. 640, 29 S. 469)

18. Hugh Hibbard and several friends drove to London, Kentucky, to meet a train arriving at two o'clock in the morning for the purpose of receiving the body of Mrs. Hibbard from the express company. There was no night agent at London, and delivery was refused because of a rule of the company requiring everything carried by the company to be taken a short distance further to Corbin, Kentucky, where there was

a night agent, and to be returned to London the next morning. Thereafter Hibbard brought an action against the express company to recover damages. Was he entitled to judgment? (Adams Express Co. v. Hibbard, 145 Ky. 818, 141 S. W. 397)

19. Lacey L. Hardesty, trading as the Hardesty-Eskridge Company, shipped by express two hundred and fifty-three crates of strawberries from Seaford, Delaware, to Jersey City, New Jersey. The carrier furnished a refrigerator car, but it did not re-ice the car while it was en route to its destination. Hardesty brought an action against the express company to recover damages. Was he entitled to judgment? (Hardesty v. American Ry. Express Co., 2 W. W. Harr. [Del.] 66, 119 A. 681)

20. William Conroy was a passenger on a train from Ellsworth to Marshfield, Wisconsin. He left the train under the direction of the carrier for the purpose of walking around a wreck to board a train on the other side. During such time Conroy was injured by the explosion of naphtha in one of the wrecked tank cars. In an action brought by Conroy against the carrier to recover damages, a question arose as to whether he was a passenger at the time of the injury. What is your opinion? (Conroy v. Chicago, St. P., M. & O. Ry. Co., 96 Wis. 243, 70 N. W. 486)

21. The Little Mountain Oil & Fertilizer Company shipped a quantity of cottonseed meal over the lines of the Columbia, Newberry & Laurens Railroad Company. The carrier issued a bill of lading for a car of five hundred bags of cottonseed meal, which was marked to show that only the shipper had loaded the car and counted the bags. The bill of lading was transferred to the Palmetto Fertilizer Company, a bona fide purchaser, who found that the car had only two hundred bags. The Palmetto Fertilizer Company brought an action against the carrier to recover the value of three hundred bags of meal. Was it entitled to judgment? (Palmetto Fertilizer Co. v. Columbia, N. & L. Ry. Co., 99 S. C. 187, 83 S. E. 36)

22. A common carrier by trucks transported a donkey engine for McDowell from Seattle to a place of construction. The engine was delivered without payment of the charges. Thereafter, McDowell employed the carrier to transport the engine back to Seattle. The carrier sought to hold the engine until both charges were paid. Was it entitled to do so? (Contractors' Machinery & Storage Co. v. Guegnen, 145 Wash. 430, 260 P. 669)

23. The F. E. Mathias Lumber Company shipped a carload of lumber to the Royal Wilhelm Furniture Company at Sturgis, Michigan. The carrier brought an action against the shipper to collect the unpaid charges. It was contended that the consignor is ordinarily liable for carriage charges. Was this contention sound? (Pennsylvania R. Co. v. F. E. Mathias Lumber Co., 113 Ind. A. 133, 47 N. E. [2d] 158)

CHAPTER IX

VENDOR AND VENDEE

Part I—General Considerations

Introduction. Sales constitute one of the oldest forms of business transactions. The practice of transferring personal property has existed since the days of earliest civilization, although in earlier times it took the form of barter rather than that of what is now technically known as a sale. Transfers of personal property were then of a more or less formal nature. Under the Roman law, for example, the validity of a sale depended upon a public ceremony, involving requirements which had to be met with exactness.

The most common form of business transaction today is the sale of personal property. Buying and selling constitute the major portion of our economic activities. Scarcely a day passes but that a majority of people buy or sell something. It is therefore desirable, if not necessary, that persons generally have an appreciation of the rules, sometimes technical in nature, which govern these transactions, and the rights and obligations arising from their formation.

The law of sales, as it is known today, is a body of principles, standards, and rules developed from the mercantile law under the common law of England, as modified by the Statute of Frauds and by other statutes enacted in the various states in this country. A Uniform Sales Act,[1] formulated by the Commissioners on Uniform Laws for the purpose of bringing about uniformity in this branch of the law, has been adopted by most state legislatures.

Definition. A *sale* of personal property is a transaction whereby one party transfers the general ownership in specific chattels to another for a consideration in money termed the *price*. The party who transfers the property in the goods is called the *seller* or *vendor*, and the transferee is called

[1] Hereafter called the Sales Act.

the *buyer* or *vendee*. The Sales Act states that "a sale of goods is an agreement whereby the seller transfers the property in goods to the buyer for a consideration called the price." [2]

> The Sales Act has been adopted in Ala., Alaska, Ariz., Ark., Calif., Colo., Conn., Del., Dist. of Columbia, Hawaii, Ida., Ill., Ind., Iowa, Ky., Me., Md., Mass., Mich., Minn., Nebr., Nev., N. H., N. J., N. Y., N. D., Ohio, Oreg., Pa., R. I., S. D., Tenn., Utah, Vt., Wash., Wis., and Wyo. (Uniform Laws Annotated, vol. 1, Cumulative Annual Pocket Part, for use during 1947)

An important characteristic of a sale is the transfer of general property rather than of special property in the goods. In a bailment the transfer is not a sale, as only a special property in the goods passes to the party receiving possession; the general property remains in the owner. For example, when goods are put in the possession of another to secure a debt, the pledgor may transfer the general property or ownership which remains in him to a third person.[3]

> In a sale there "is a transfer of the general or absolute property as distinguished from a special property." (Union Securities v. Merchants' Trust & Savings Co., 205 Ind. 127, 185 N. E. 150)

It should be remembered that a sale of goods is based upon a valid agreement. The essential elements of a contract which have been discussed are therefore necessary in a contract of sale.

Classification. Sales are sometimes divided into three classes, two of which include agreements which are not strictly sales.

Executed Sales. Executed sale is a term frequently used to describe a sale as it has been defined. It refers to an agreement under which the general property in goods is transferred. The contract of sale is therefore said to be executed. The term *sale* alone is preferable to indicate such an agreement.

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[2] §1—(2).
[3] *Harper* v. *Godsell*, L. R. 5 Q. B. 424.

Executory Sales. Executory sale is a term sometimes employed to indicate an agreement under which property in goods is to pass to another in the future. An agreement of this kind is not a sale; it is a contract to sell. In a sale the property is transferred, whereas in a contract to sell, the promisor merely binds himself to transfer the property. The Sales Act states that "a contract to sell goods is a contract whereby the seller agrees to transfer the property in goods to the buyer for a consideration called the price." [4]

Conditional Sales. A conditional sale is an agreement under which property in goods is to pass to another upon the fulfillment of designated conditions. These agreements are merely contracts to sell, and not sales. If the buyer takes possession of the goods under an agreement that the property is not to pass until the purchase price is paid, the transaction closely resembles a chattel mortgage. For this reason many states, particularly those which have adopted the Uniform Conditional Sales Act, require these contracts to be filed or recorded.[5]

> "The characteristic feature of the conditional sale is the retention of the title by the seller, notwithstanding possession, use, and appearance of ownership by the buyer." (Universal Finance Corporation v. Hamner, 61 S. D. 540, 250 N. W. 33)

The distinction between sales and contracts to sell is important, because the risk of loss ordinarily falls upon the one who has ownership or title. To illustrate, when the agreement transfers the property in the goods, the buyer suffers the loss in the event of subsequent destruction.[6] An exception to the general rule is made by most courts when possession is given to the buyer and the property in the goods is retained by the seller merely to insure performance on the part of the buyer. In this situation the buyer assumes the risk of loss. This rule is adopted by the Sales Act.[7]

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[4] §1—(1).
[5] *Cahill's Consolidated Laws of New York*, ch. 42, §60.
[6] *Bill* v. *Fuller*, 146 Calif. 50, 79 P. 592.
[7] §22—(a).

Subject Matter of Sales. Goods, which form the subject matter of sales, include only personal property but not all forms of it. The term clearly embraces all *corporeal chattels personal.* It excludes *choses in action,* a form of property which is transferred by assignment or by negotiation. Money is a form of personal property not ordinarily included in the term *goods.* The Sales Act provides that "goods include all chattels personal other than things in action and money." [8]

Generally speaking, a person cannot sell nonexistent goods or goods which he does not presently own. Thus, when one purports to sell to another all the fish he may catch on the following day, the latter cannot claim ownership of the fish caught on the fishing trip.[9] One may, however, make a contract to sell goods not in existence or which are to be acquired. The Sales Act states that "where the parties purport to effect a present sale of future goods, the agreement operates as a contract to sell goods." [10]

> Courts sometimes state that one may sell property "which the seller may intend to acquire title," but apparently mean "contract to sell." (Spielberg v. Harris, 202 Wis. 591, 232 N. W. 547)

Potential Existence. To the general rule that a person cannot sell nonexistent goods, courts have made a limited exception. They have said that a person may presently sell goods if he owns the source from which they are to come. For example, a person sells the peaches to be grown upon his trees to another. This is treated as a valid, present sale.[11] This exception, applied to the sale of goods having "potential existence," does not appear to have been followed by the Sales Act.

> Some courts still refer to the sale of goods in potential existence, but without citing the Sales Act. (Merrill v. California Petroleum Corp., 105 Calif. A. 737, 288 P. 721)

When a person agrees to sell specific, existing property, there is a condition in the agreement that the property is

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[8] §76—(1).
[9] *Low* v. *Pew,* 108 Mass. 347.
[10] §5—(3).
[11] *Dickey* v. *Waldo,* 97 Mich. 255, 56 N. W. 608.

then in existence and shall be in existence at the time the agreement is to be executed by the passing of the title. For example, if a person sells to another a cargo of wheat which, unknown to the parties, has been destroyed, the agreement is unenforceable.[12] This rule is adopted by the Sales Act which also provides that, in the event of partial destruction, "the buyer may treat the sale (a) as avoided or (b) as transferring the property in the goods, or in such as have not deteriorated, and as binding him to the full agreed price if the sale was indivisible, or the agreed price for the goods in which property passes if the sale was divisible." [13]

The Consideration. Consideration in the form of price is a necessary element of a sale. There can be no sale without a price. Payment, however, may be made in any form of personal property. A consideration stated in terms of money, called the price, is the characteristic that distinguishes a sale from other agreements transferring ownership in goods, such as a gift or a barter. A gift is a gratuitous transfer of property. A barter is an exchange of property for other property or for services.

> "A consideration of money or its equivalent is a necessary element of a sale, as opposed to a barter and exchange or gift." (In re Franks' Estate, 154 Misc. 472, 277 N. Y. S. 573)

The price may be fixed by express agreement or determined later in an agreed manner. To illustrate, the parties to a given transaction may agree that the price shall be fifty cents more than the market price of such goods in a certain city upon date of delivery.[14] If the goods are sold and the price therefor is not fixed, it is implied that the buyer is to pay a reasonable price. A reasonable price is ordinarily the market price, but not necessarily, as when the market price is under the control of the seller. The question is one of fact to be determined in view of the circumstances of each case.

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[12] *Hamilton* v. *Park & McKay Co.*, 125 Mich. 72, 83 N. W. 1018.
[13] §7.
[14] *Shaw* v. *Smith*, 45 Kans. 334, 25 P. 886.

When timber was sold without stipulation as to price, "the law intervened and fixed the reasonable value of the timber as the agreed price by implication." (Sims v. Alford, 218 Ala. 216, 118 S. 395)

The parties may agree that the price shall be fixed by a third person. If such person, through no fault of either buyer or seller, fails to fix the price, the sale or contract to sell is unenforceable by either. The buyer must, of course, pay a reasonable price for goods actually delivered and accepted under such an agreement. This rule is adopted by the Sales Act.[15]

Illegality. It has been pointed out in the law of contracts that an unlawful agreement is unenforceable. A sale or an agreement to sell may be illegal by common law or by statute.

By Common Law. At common law a sale is illegal if the subject matter is *per se* bad. To illustrate, if a person makes a contract to sell an indecent picture to another, the agreement is unlawful because of its tendency to corrupt the morals of the community.[16] Although the object of the sale may be unobjectionable in itself, the transaction may be illegal, as when the agreement provides that the object of the sale shall be employed for some unlawful purpose, or when the seller assists in the unlawful act. To illustrate, when the seller falsely brands goods, representing them to be imported, to assist the vendee in perpetrating a fraud, the sale is illegal.[17] The mere fact, however, that the vendor has knowledge of the vendee's unlawful purpose does not, under the general rule, make the sale illegal, unless the purpose is the commission of a serious crime.

It was held, in an action for the price of sugar, that it was no defense to show that seller knew that it was to be used in making intoxicating liquor in violation of the law, since the sale did not require the buyer to so use the goods and the seller did "nothing in aid or furtherance of the unlawful design." (Gallick v. Castiglione, 2 Calif. A. [2d] 716, 38 P. [2d] 858)

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[15] §10.
[16] *Fores* v. *Johnes*, 4 Esp. 97.
[17] *Materne* v. *Horwitz*, 101 N. Y. 469, 5 N. E. 331.

By Statutes. Legislation in the various states invalidates many types of sales. Only a few of those statutes can be noted. Statutes in many states prohibit business transactions on Sunday, including sales.[18] Practically every state has legislation prohibiting certain sales when they are not conducted according to the requirements of the statutes. Thus a statute may require that a particular class of goods be inspected before a legal sale thereof can be made.[19] An important statutory prohibition in all the states is that of sales of an entire stock of goods. The purpose of this law, which is ordinarily called the Bulk Sales Act, is to prevent fraud upon creditors which would result from the secret sale of a merchant's goods in bulk for cash. These sales are declared invalid by such statutes unless sufficient notice is given to the creditors.[20] Statutes also make sales fraudulent as to creditors when an insolvent seller, without regard to his actual intent, does not receive a fair consideration or when a seller disposes of his goods with actual intent to hinder, delay, or defraud either present or future creditors.[21]

Legislation regulating sales of certain kinds of farm machinery was held to be constitutional. (Bratberg v. Advance-Rumely Thresher Co., 61 N. D. 452, 238 N. W. 552)

Effect of Illegality. An illegal sale or contract to sell cannot be enforced. This rule is based on public policy. As a general rule, courts will not aid either party in recovering money or property transferred pursuant to an illegal agreement. Relief is sometimes given, however, to an innocent party to an unlawful agreement. For example, if one party is the victim of a fraudulent transaction, he may recover what he has transferred to the other, even though the agreement arose out of some illegal scheme.[22]

QUESTIONS

1. "The most common form of transaction today is the sale of personal property." Do you agree?

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[18] *Ante*, page 112.
[19] *McConnell* v. *Kitchens*, 20 S. C. 430.
[20] *Cahill's Ill. Rev. Statutes* (1929), ch. 121A, §1.
[21] *Uniform Fraudulent Conveyance Act*, §§4 and 7.
[22] *Woodham* v. *Allen*, 130 Colo. 194.

2. A farmer drove a horse and cart to the city for the purpose of securing some feed. While he was in the city, the cart was damaged beyond repair. The farmer thereupon made a deal with an automobile agency whereby he exchanged the horse for a secondhand automobile. Was this transaction a sale?

3. Steward tells Hill that he is moving from the city but that he does not know whether he should take his furniture as he is not certain whether the change is to be permanent. Hill agrees to take the furniture and pay for its use until Steward returns or sends for it. Does this agreement constitute a sale?

4. Kinglon attempts to sell a radio set to Portsmouth upon every occasion they meet. Finally the latter agrees to purchase, and the former to sell, a radio for a given price on the tenth of the following month. Kinglon contends that the transaction is an executory sale. Portsmouth contends that it is not a sale at all. Do you agree with either Kinglon or Portsmouth?

5. Wightman agreed to sell his truck on the following Tuesday to B. F. Grager. On the Saturday following the agreement, the truck was destroyed by fire, without fault of either party. When Grager refused to pay the agreed purchase price on Tuesday, Wightman brought an action to collect the amount, contending that the loss fell upon Grager. Was his contention sound?

6. Bindloss executes a promissory note for five hundred dollars payable to Horton, and delivers the instrument to the latter in payment of a debt. Horton transfers the note to Migron for four hundred and fifty dollars. Is this transaction a sale?

7. Snowden, who is starting on a hunting trip, is requested by Erquardt to sell the latter all of the game killed. Snowden agrees to do so. When he returns with a bear and a deer, his creditors levy on the property. Erquardt sues them for conversion alleging that the property belongs to him. Is he entitled to judgment?

8. Tierney, while examining Kirsner's bookcase, offers to buy it. Kirsner agrees to sell it to Tierney, and the latter takes it home with him. Neither party mentions the price. Later Kirsner brings an action against Tierney, who contends that the transaction was not a sale as no price was stipulated. Is this contention sound?

9. Frank S. Dalrymple delivered an electric stove to Wahl. In return therefor, Wahl agreed to deliver on the following day a quantity of potatoes having a market value equal to the sum of $18.75. Thereafter Dalrymple brought an action against Wahl, basing his action on the theory that the transaction came within the provisions of the Sales Act. Was his theory correct?

10. Milroy sells a horse to Gishman on credit. The latter purchases the horse for racing purposes. After entering the animal in several races, he refuses to pay for it. Milroy brings an action on the contract. If horse racing is prohibited by law, is he entitled to judgment?

Part II—Form of Contract

Sales in Writing. At common law parol sales were enforceable. Statutes in most states, however, require written evidence of sales of a certain kind. These statutes vary in details, but they follow substantially the provisions of the old English statute, enacted in 1676, which is known as the Statute of Frauds.

Statute of Frauds. The provisions of the seventeenth section of the English Statute of Frauds are that "no contract for the sale of any goods, wares, or merchandise, for the price of ten pounds sterling, or upward, shall be allowed to be good, except (a) the buyer shall accept part of the goods so sold, and actually receive the same, (b) or give something in earnest to bind the bargain, or in part payment, (c) or that some note or memorandum in writing of the said bargain be made and signed by the parties to be charged by such contract, or their agents thereunto lawfully authorized." [1]

This section has not been adopted as uniformly as the fourth section which has been considered previously.[2] In some states this section is omitted entirely. It is, however, adopted with some modifications by the Uniform Sales Act.[3]

> The following states do not have a provision corresponding to the seventeenth section of the Statute of Frauds: Kansas, Louisiana, New Mexico, North Carolina, Texas, Virginia, and West Virginia.

Goods, Wares, and Merchandise. The phrase "goods, wares, and merchandise" is generally interpreted in this country to embrace practically all forms of personal property. Thus the sale of stocks, bills, and notes comes within its meaning.[4] The Sales Act adopts the phraseology "any goods or choses in action." [5]

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[1] *St. of 29 Car. 11*, ch. 3.
[2] *Ante*, p. 132.
[3] §4.
[4] *Gooch* v. *Holmes*, 41 Me. 523.
[5] §4—(1).

Sales or Contracts to Sell. In this country the term *sale of goods* has been uniformly held to include contracts to sell as well as sales of goods. The Sales Act expressly states that its provisions shall apply to a "contract to sell or sale."

Amount. Sales need not be proved by the specified evidence when the price is less than the amount designated in the statute. This amount is $500 in over a third of the states, but it varies, ranging from $30 to $2,500. The Uniform Sales Act prescribes $500. If the oral sale is of several inexpensive articles, it is enforceable only when the total sum is less than the statutory amount. To illustrate, a buyer went to a linen draper and bargained for various articles. The agreed price for each was less than the statutory amount. It was held that the various transactions constituted a contract within the provisions of the Statute of Frauds.[6]

> In one state no amount is specified; hence the statute applies to all sales and contracts to sell. (Code of Iowa, 1939, Sec. 9933-1)

Void or Voidable. Another ambiguous phrase in the original statute is that no contract "shall be allowed to be good." It is not clear whether this phrase means that the agreement is void or merely voidable at the election of the other party. A majority of states in this country hold that the provision renders the agreement voidable. This is in harmony with the interpretation of the fourth section which provides that "no action shall be brought." In some states, however, the provision expressly or impliedly renders the agreement void. The Sales Act substitutes another phrase, expressly stating that the agreement "shall not be enforceable."

Proof of Sales. The Statute of Frauds provides three modes by which oral sales over the designated amount may be proved. These modes are by accepting and receiving part of the goods; by giving something in earnest, or in part payment; and by executing a note or memorandum.

Acceptance and Receipt. When a sale is proved by the buyer's receipt and acceptance of all or part of the goods,

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[6] *Daldey* v. *Parker*, 2 Barn. & C. 37.

both a receipt and an acceptance are necessary; neither alone will suffice. They need not, however, be concurrent; the receipt may follow or precede the acceptance. If the parties intend that there be a receipt of part of the goods in performance of the contract, the quantity received is immaterial.

Acceptance is the assent of the buyer to become the owner. This may be express or implied. It will be implied by any conduct which indicates that the buyer considers the goods as belonging to him. Thus, if the buyer receives the goods and later resells them, the buyer's acceptance is implied.[7] The Sales Act declares that "there is an acceptance of goods within the meaning of this section when the buyer, either before or after delivery of the goods, expresses by words or conduct his assent to becoming the owner of those specific goods." [8]

A receipt of goods within the meaning of the statute takes place when the buyer, with the consent of the seller, assumes possession of them or takes dominion over them. A receipt is clearly proved when the buyer takes actual physical possession of them. It is equally clear when he takes possession of a symbol of the goods, such as the document of title or the key to the warehouse in which the goods are stored. Courts are agreed that there may be a receipt of the goods within the meaning of the statute, even though neither the goods nor any symbol of them is delivered. This occurs when the person in possession of them, with the consent of the parties, agrees to hold them for the buyer. It also occurs, in some states, when the seller agrees to hold them for the buyer in some new capacity. For example, if the seller agrees to keep the goods as a bailee, there is a receipt by the buyer within the meaning of the statute.[9]

> A delivery of stock to the seller's agent does not amount to a receipt thereof by the buyer. (Rabe v. Danaher, 51 F. [2d] 777)

Earnest Money or Part Payment. Another mode of proving sales is that in which the buyer "gives something in earnest to bind the bargain, or in part payment." *Earnest* is the giving of money, a token, or a pledge to bind the bargain. This

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[7] *Marshall* v. *Ferguson*, 23 Calif. 66.
[8] §4—(3).
[9] *Green* v. *Merriam*, 28 Vt. 801.

practice, however, has largely become obsolete. Part payment occurs when the buyer gives something of value which is accepted by the seller in performance of the contract. The payment need not, however, be in money. For example, a check which the seller takes as part of the price is sufficient to prove the oral contract.[10] In most states the part payment may be made after the contract of sale.

Note or Memorandum. The note or memorandum required by the statute is merely evidence of the contract. It need not be in any prescribed form. It should, however, contain substantially all of the terms of the agreement. The contents of the note or memorandum have been discussed previously and need no further attention.[11]

Contracts for Labor and Materials. In applying this section of the Statute of Frauds, it is often difficult to distinguish a sale from a contract for services. This is particularly true when the agreement contemplates the manufacture of a finished product. The provisions of the statute apply if the transaction is a sale, but they do not if it is a contract for services. Several rules applicable to this situation have been developed.

English Rule. This rule declares that if the agreement contemplates the transfer of the ownership of an object which in its finished state is a proper subject of a sale, the transaction constitutes a sale under the provisions of the statute. To illustrate, a person orally ordered two sets of teeth for which she agreed to pay $105. When the teeth were made, the patient refused to pay for them. The dentist brought an action for the price, claiming that the contract was for labor and materials and was therefore not required to be in writing. The court held that the agreement was a contract to sell goods and an unenforceable agreement because it was not in writing.[12]

New York Rule. Courts in New York take a view directly opposite to the English rule. They say that if the object is not in existence at the time of the agreement, the transaction

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[10] *Hunter* v. *Wetzell*, 84 N. Y. 549.
[11] *Ante*, p. 135.
[12] *Lee* v. *Griffin*, 1 Best & Smith 272.

is a contract for labor and materials. Thus, in the case discussed in the preceding paragraph, the dentist under this rule could collect the agreed amount.[13]

Massachusetts Rule. Courts in Massachusetts adopt a middle ground. They say that an agreement comes within the provisions of the statute when the object, if not then in existence, is one which the seller in the usual course of his business manufactures for the general market. When, however, the object is to be made to special order, the agreement is treated as a contract for labor and materials and is not controlled by the provisions of the statute. By way of illustration, if a dentist agrees to sell a set of teeth already made or a set which he regularly makes and which is suitable for the general market, the statute will control the agreement. If, however, he makes a set to order, the statute does not apply.[14] The Massachusetts rule has generally been followed in this country, and it is sometimes called the American rule. It is adopted by the Sales Act.[15]

Growing Crops. An interesting question arises as to whether a present sale of growing crops comes within the provisions of the fourth or seventeenth section of the Statute of Frauds. Natural grass and other natural products of the soil, known as *fructus naturales,* are usually treated as real property, and a present sale of them is governed by the fourth section. For example, a person makes a sale of certain standing timber to another with the agreement that the timber is to be cut as soon as possible. This sale in most states comes within the provisions of the fourth section of the statute.[16]

> A sale of standing timber was "regarded as involving real estate." (Smith v. Thomas, 224 Ala. 41, 138 S. 542)

On the other hand, under the general rule, an agreement for the present sale of crops, known as *fructus industriales,* which are the product of annual care and industry, relates to personal property and is not governed by the fourth section.

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[13] *Cooke* v. *Millard,* 65 N. Y. 352.
[14] *Goddard* v. *Binney,* 115 Mass. 450.
[15] §4—(2).
[16] *Flaharty* v. *Mills,* 49 W. Va. 446, 38 S. E. 521.

To illustrate, a present sale of growing potatoes comes under the seventeenth section in most states.[17] Lack of uniformity on this question is apparently settled by the Sales Act which provides that " 'goods' includes all chattels personal other than things in action and money. The term includes emblements, industrial growing crops, and things attached to or forming

Know all Men by these Presents:

That I, Jerry McDonald, of the city of Bristol, in consideration of the sum of Two Hundred Dollars- - - -

part of the land, which are agreed to be severed before the sale or under the contract of sale." [18]

Bill of Sale. Quite aside from statutory requirements of writing, the parties in many transactions deem it advisable to reduce contracts to sell and sales to writing. This is usually done by a formal written agreement called a *bill of sale.* A bill of sale is valuable evidence of the transaction and is particularly desirable when a physical delivery of the goods has not been made. Statutes in some states require that the possessor of property of certain types, as for example, an automobile, be prepared to show a bill of sale upon the request of an officer. When the goods are to be left in the hands of the seller, the bill of sale should be recorded to protect the buyer against a transfer to a subsequent vendee.[19]

QUESTIONS

1. Sigmon orally agreed to purchase a trailer from Vreel. When he failed to carry out his promise, Vreel brought an action to recover damages from him. Sigmon contended that because the requirements of the Statute of Frauds had not been met, the agreement was rendered void. Was his contention sound?

2. Roth orally agrees to purchase ten shares of stock from Naughton. The agreed price is eleven hundred dollars. Later Roth refuses to accept and pay for the stock. Naughton brings an action for damages against Roth who pleads the Statute of Frauds as a defense. Naughton contends that the Statute of Frauds does not apply to a sale of stock. Is his contention sound?

3. Cutner orally agrees to sell one hundred head of cattle to Rainey on the following day. The next day Cutner refuses to perform, and Rainey brings an action for damages. The former pleads the Statute of Frauds as a defense. Rainey contends that the provisions of the statute do not apply to contracts to sell. Do you agree?

4. Morgan accepts an offer of six hundred dollars from Griffin for a given quantity of salt. The latter pays fifty dollars on account and agrees to pay the balance in sixty days. When Morgan fails to deliver the goods, Griffin brings an action for damages. Morgan contends that the agreement is not enforceable because it was not in writing. Is his contention sound?

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[18] §76—(1).
[19] *Post,* p. 583.

5. Tupper orally agrees to sell a given quantity of wheat to Doran for fifteen hundred dollars. Doran places part of the wheat in a truck and takes it with him at the time of the agreement. Later he refuses to accept the remainder. Tupper brings an action for breach of contract. Doran's defense is that the agreement is not in writing. Is this a valid defense?

6. The White Manufacturing Company brings an action for damages against the Primrose Company, alleging a breach of contract to purchase two hundred half-barrels of Georgia cane syrup. The Primrose Company pleads the Statute of Frauds as a defense. The White Manufacturing Company offers as a written contract the following instrument:

> White Manufacturing Company, Columbus, Georgia.
>
> 200--one-half barrels Georgia Cane, 23.
>
> December 1, 1939.
>
> White Manufacturing Co.

Is the White Manufacturing Company entitled to judgment?

7. Payne enters into a parol agreement to pay seven hundred dollars to Wainwright for a given quantity of cotton. The latter gives him the bill of lading issued by the carrier holding the goods. Later Payne contends that the agreement is unenforceable because he has not received the goods or any part of them. Is his contention sound?

8. Masters enters into a parol agreement with Hurst to make a tractor for nine hundred dollars. When the tractor is finished, Hurst refuses to accept and pay for it. Masters brings an action on the contract for damages against Hurst who pleads the Statute of Frauds as a defense. Is Masters entitled to judgment?

9. Hyman has a grove of walnut trees on his farm. Lindsay orally agrees to pay him two thousand dollars for the timber as it stands. The agreement also provides for the severance and removal of the timber by Lindsay. Later Hyman refuses to allow Lindsay to take the timber. Lindsay brings an action for breach of contract. Hyman's defense is that the agreement is not enforceable because it is not in writing. Is this a valid defense?

10. Sargent enters into a parol agreement with Murray for the sale of the peaches, then growing in the former's orchard, for a specified sum. The agreement provides that Murray is to gather and remove the peaches as they mature. Murray pays seventy-five dollars as a part payment of the purchase price and gathers the peaches as they mature. Sargent brings an action for the remainder of the purchase price, and Murray contends that the agreement is unenforceable because it is not in writing. Is his contention sound?

Part III—Conditions and Warranties

Conditions. A sale or a contract to sell may be conditional or absolute. When it is conditional, the obligation of one or both parties to the agreement is subject to the performance of certain acts or the happening of certain events. For example, a seller agrees to deliver five hundred bales of hops on specified dates starting with October 15, and the buyer agrees to advance two thousand dollars on September 1 to enable the seller to obtain the goods. The advance is a condition precedent to performance by the seller.[1]

> When a contract for purchase was to be "no good" until down payment was made, the purchaser was held not liable thereon, "the contingency upon which the contract was to go into effect having never happened." (Bultman v. Frankart, 194 Wis. 296, 215 N. W. 432)

In the event that a condition precedent to the obligation of one party is not fulfilled, that party may repudiate the transaction or waive nonfulfillment of the condition and hold the other party to his promise. If there is a promise that the condition shall happen or be performed, the promisee may treat nonperformance thereof as a breach of warranty. The Sales Act further provides that "where the property in the goods has not passed, the buyer may treat the fulfillment by the seller of his obligation to furnish goods as described and as warranted expressly or by implication in the contract to sell, as a condition of the obligation of the buyer to perform his promise to accept and pay for the goods." [2]

Express Warranties. A *warranty* is a promise or undertaking on the part of the seller in respect to the subject of the sale. It may relate to present or future time. An express warranty is a collateral agreement, made either at the time of contract of sale or subsequently. In the former case the buyer's consideration to support the seller's promise to sell supports also the collateral promise. In the latter case a

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[1] *Straus* v. *Russell Co.*, 85 F. 589.
[2] §11—(2).

consideration, other than the buyer's promise to pay, or the payment of, the purchase price, must be given.

No particular form of words is necessary to constitute a warranty. To illustrate, a seller does not expressly state that he warrants a horse which he is selling, but says, "I promise you the horse is sound." This is an express warranty.[3] Some states require that the seller have the intent to warrant or, in other words, actually consent "to be bound for the truth of his representation." It is sufficient, however, in the majority of states that the seller assert a fact which would naturally induce the vendee to rely and act on the statement. The Sales Act declares that "any affirmation of fact, or any promise of the seller relating to the goods, is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon. No affirmation of the value of the goods, nor any statement purporting to be a statement of the seller's opinion only, shall be construed as a warranty." [4]

> When a seller wrote that corn "inspects No. 3 yellow, 21% moisture," it was held that "there was a warranty contained in the letter as to the condition and quality of the corn." (Herman-McLean Co. v. Carpenter, 37 Ohio A. 58, 174 N. E. 160)

Although a statement of opinion or of belief by the vendor does not constitute a warranty, the seller may, however, be liable when he does not have the belief claimed. For example, when the seller knows that a horse is unsound and refuses to warrant the animal, but states that it is sound so far as he knows, his statement is a warranty as to his knowledge of unsoundness.[5] Commendations or expressions of praise customarily employed by vendors to induce a purchase are not warranties. They are puffs or trade talk in which the vendee is not permitted to place reliance. Thus the laudatory statement of a seller that "this is the best piece of cloth in the market" is merely an opinion.[6] Whether a given statement is

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[3] *Chapman* v. *Murch*, 19 John. (N. Y.) 290.
[4] §12.
[5] *Wood* v. *Smith*, 5 Man. & R. 124.
[6] *Strauss* v. *Salzer*, 58 Misc. Rep. 573, 109 N. Y. S. 734.

a warranty is a question for the jury to determine in view of the circumstances of each case.

> Statements of a saleswoman that a fur coat was a good coat, would wear very good, and that the buyer would not be sorry if she bought it, were held not to be warranties. (Keenan v. Cherry & Webb, 47 R. I. 125, 131 A. 309)

An express warranty may be general or special. A general warranty ordinarily does not include defects which are known or should have been known to the buyer, as those which could have been discovered by inspection. This rule does not apply, however, when the seller takes steps to conceal otherwise obvious defects. To illustrate, if the seller conceals a permanent lameness of a horse by assuring the buyer that the faltering of the animal is due to a slight temporary stiffness caused by weariness and cold on a steamship, a general warranty extends to this defect.[7] When the buyer is doubtful about a given matter, he may require and receive a statement which will amount to a warranty, or he may insist upon a special warranty in respect to the matter.

Caveat Emptor. One of the oldest rules of the common law is the maxim of *caveat emptor* (let the buyer beware). Courts at common law rigidly applied this rule, requiring the purchaser in the ordinary sale to act in reliance upon his own judgment, except when the seller made him an express warranty. The nature and scope of this doctrine is clearly set forth in the following opinion of the Supreme Court of the United States by Mr. Justice Davis: "No principle of the common law has been better established, or more often affirmed, both in this country and in England, than that in sales of personal property, in the absence of express warranty, where the buyer has an opportunity to inspect the commodity and the seller is guilty of no fraud, and is neither the manufacturer nor the grower of the article he sells, the maxim of caveat emptor applies. Such a rule, requiring the purchaser to take care of his own interests, has been found best adapted to the wants of trade in the business transactions of life. And

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[7] *Chadsey* v. *Greene*, 24 Conn. 560.

there is no hardship in it, because if the purchaser distrusts his judgment he can require of the seller a warranty that the quality or condition of the goods he desires to buy corresponds with the sample exhibited. If he is satisfied without a warranty, and can inspect and declines to do it, he takes upon himself the risk that the article is merchantable. And he cannot relieve himself and charge the seller on the ground that the examination will occupy time and is attended with labor and inconvenience. If it is practicable, no matter how inconvenient, the rule applies. One of the main reasons why the rule does not apply in the case of a sale by sample is that there is no opportunity for a personal examination of the bulk of the commodity which the sample is shown to represent. Of such universal acceptance is the doctrine of caveat emptor in this country, that the courts of all the states in the Union where the common law prevails, with one exception (South Carolina), sanction it." [8]

Implied Warranties. The common-law rule appears harsh in the abstract. Courts, however, have to a considerable extent softened its rigor by implying warranties in certain situations. An express warranty on the part of the seller does not negative the warranties which the law implies.[9]

Warranty of Title. When one sells goods in his possession, he impliedly warrants title, unless the contrary is indicated by the surrounding circumstances. For example, a person selling a one-half interest in certain goods in his possession, which actually belong to another, is liable to the buyer on an implied warranty of title.[10] English courts apply the same rule even when the seller does not have possession of the goods. This rule has been followed by modern decisions in this country and has been adopted by the Sales Act.[11]

> The rule in New York was changed by the Sales Act, "so that there is now an implied warranty of title, whether or not the seller is in possession of the goods." (Spotless Co. v. Commercial Trust Co., 215 App. Div. 412, 214 N. Y. S. 10)

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[8] *Barnard* v. *Kellogg*, 10 Wall. (U. S.) 383, 19 L. Ed. 987.
[9] *Sales Act*, §15—(6).
[10] *Shattuck* v. *Green*, 104 Mass. 42.
[11] § 13—(1).

The Sales Act provides that a seller makes "an implied warranty that the buyer shall have and enjoy quiet possession of the goods as against any lawful claims existing at the time of the sale," and that there is "an implied warranty that the goods shall be free at time of the sale from any charge or encumbrance in favor of any third person, not declared or known to the buyer before or at the time when the contract or sale is made." [12]

A seller makes no implied warranty when he transfers merely the interest which he possesses. There is no implied warranty when a person sells in a representative capacity. For example, a sheriff, an auctioneer, a mortgagee, or an administrator, selling the goods of another person, makes no implied warranty.[13]

> It has been held that when the parties did not contemplate an unencumbered title to an orchestration, there was no implied warranty that the orchestration was unencumbered. (Dreisbach v. Eckelkamp, 82 N. J. L. 726, 83 A. 175)

Warranty of Quality. When the seller is not the manufacturer and the buyer has an opportunity to inspect the goods, there is usually no implied warranty as to quality. There are, however, a few exceptions to this general rule.

If the buyer expressly or impliedly makes known to the seller the purpose for which he wishes an article and indicates that he relies upon the skill and judgment of the seller in the selection of such an article, the seller, in the absence of facts showing contrary intent, impliedly warrants that it is reasonably fit for that purpose. By way of illustration, if the buyer asks the seller to ship a number of clay pots which are suitable for heating and retaining molten glass in glass factories, he relies upon the judgment of the seller who impliedly warrants that such objects are reasonably fit for that use.[14] Some courts apply this rule only to manufacturers and growers, but most courts include dealers as well. The Sales Act applies the rule whether the seller "be grower, manufacturer,

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[12] §13—(2), (3).
[13] *Johnson* v. *Laybourn*, 56 Minn. 332, 57 N. W. 933.
[14] *Queen City Glass Co.* v. *Clay Pot Co.*, 97 Md. 429, 55 A. 447.

or not." [15] The rule does not apply, however, if the buyer orders "a specified article under its patent or trade name." [16] To illustrate, a person orders a given number of bricks of a grade known as common, intending to use them in the walls of a building. Should it develop that the bricks are unfit for that purpose, the seller is not liable on an implied warranty.[17] If the buyer had requested the seller to send bricks suitable to be used in the walls of a building, the rule stated above would then apply, because the buyer would be relying on the judgment of the seller.

> When the seller knew that caps were to be used to bottle ginger ale, and the buyer relied on seller's judgment, there was an implied warranty that caps were reasonably fit for that purpose. (Truslow & Fulle v. Diamond Bottling Corp., 112 Conn. 181, 151 A. 492)

Another case of the application of the rule in regard to fitness for purpose is that in which goods are sold for consumption. In such a case there is an implied warranty on the part of the seller that the goods are wholesome and fit for consumption. The rule does not ordinarily apply, however, when food is sold for animals or, as a rule, when a person is a casual seller. To illustrate the latter, when a farmer kills and sells a hog, there is no implied warranty that it is fit for food, although he knows that the vendee buys it for that purpose.[18] The Sales Act also provides that "an implied warranty or condition as to quality of fitness for a particular purpose may be annexed by the usage of the trade." [19]

> When a buyer, who had purchased a carload of mixed food for animals, sought damages for loss of animals caused by alleged injurious ingredients therein, it was held that there was no implied warranty as to soundness of food for animals. (Royal Feed & Milling Co. v. Thorn, 142 Miss. 92, 107 S. 282)

Sales by Description. In a sale of goods by description there is an implied warranty on the part of the seller that the

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[15] §15—(1).
[16] *Sales Act*, §15—(4).
[17] *Wis. Red Pressed Brick Co.* v. *Hood*, 54 Minn. 543, 56 N. W. 165.
[18] *Sales Act*, §14.
[19] §15—(5).

subject matter shall conform to the description. There is also an implied warranty, if the buyer has not examined the goods, that they are of merchantable quality. For example, if the buyer orders "waste silk," the goods must be free from defects which would render them unfit for the purposes for which such goods are ordinarily used and unsalable as waste silk.[20] The Sales Act applies this rule even when the goods have been examined, except as to "defects which such examination ought to have revealed." [21] The seller does not impliedly warrant, however, that the goods will continue to be salable. If goods are to be shipped, it is sufficient that the goods are fit for shipment; hence loss by deterioration falls upon the buyer.

> The term "merchantable" has been defined as meaning "at least a medium quality or goodness." (Empire Cream Separator Co. v. Quinn, 184 App. Div. 302, 171 N. Y. S. 413)

Sales by Sample. In a sale by sample there is an implied warranty that the bulk of the goods shall conform to the sample in quality. A sale by sample exists when a part of the goods is displayed and the parties intend that it is to represent to the buyer the nature of the bulk. There is also an implied warranty, at least if the seller is a manufacturer, that the sample contains no latent defects which will render the goods unmerchantable. To illustrate, a person sold to another by sample some apples put up in cans. The sample cans appeared to be satisfactory, but the remainder of the goods were found to be spoiled. The seller was liable to the buyer on an implied warranty.[22] The Sales Act applies this rule to dealers also.[23] When the sale or contract to sell is made by description as well as by sample, the goods must correspond to both the description and the sample.

Remedies for Breach of Warranty. For a breach of a warranty by the seller, the buyer may resort to one of several

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[20] *Gardiner* v. *Gray,* 4 Campbell's Rep. 144.
[21] §15—(3).
[22] *Nixa Canning Co.* v. *Lehmann-Higginson Grocer Co.,* 70 Kans. 664.
[23] §16—(c).

remedies. Although courts are not uniform in their views as to the rights of the buyer in the case of breach of warranty, the Sales Act has adopted the principles supported by the weight of authority. It provides that when there is a breach of warranty, the buyer may elect one of several remedies.[24] First, he may "accept or keep the goods and set up against the seller the breach of warranty by way of recoupment in diminution or extinction of the price." Second, he may "accept or keep the goods and maintain an action against the seller for damages for the breach of warranty." It has usually been held that the buyer need not give notice of the defects, but the Sales Act requires the buyer to give notice to the seller within a reasonable time after he learns of a breach.[25] Third, he may "refuse to accept the goods, if the property therein has not passed, and maintain an action against the seller for damages for breach of warranty." Fourth, he may "rescind the contract to sell or the sale, and refuse to receive the goods or, if the goods have already been received, return them to the seller and recover the price or any part thereof which has been paid." Although this rule prevailed in many states, the courts of a majority of them held that the buyer could not rescind the contract and return the goods under these circumstances.

QUESTIONS

1. Carter agrees to sell a washing machine to Schebler for seventy-five dollars. Schebler agrees to accept and pay that sum for the machine provided it is delivered within three days. Carter delivers the machine on the fifth day following the making of the agreement. When Schebler refuses to accept and pay for the machine, Carter brings an action to recover damages. Is he entitled to judgment?

2. Lamson purchases an automobile from Bletzinger. When he returns the next day and complains of the action of the carburetor, Bletzinger states, "I promise you that the carburetor is in excellent condition." The carburetor turns out to be defective, and Lamson sues Bletzinger on an express warranty. Is he entitled to judgment?

3. Lowry, while negotiating the sale of a horse to Babnick, states, "I believe this animal is satisfactory." Babnick purchases the horse in

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[24] §69.
[25] §49.

reliance on Lowry's statement. The horse proves to be unsound, and Babnick brings an action against Lowry for breach of an express warranty. It is proved at the trial that Lowry had knowledge of the unsound condition of the animal at the time of the sale. Is Babnick entitled to judgment?

4. A vendor of a horse made a general warranty of soundness. There was a defect in one of the animal's eyes. When the vendee inquired about the condition of the eye, the vendor replied, "The horse must have got a straw in it." The vendee later brought an action for breach of warranty. Is he entitled to judgment?

5. A dealer in radios states to Lindberg, "This machine is the finest on the market at the price." The latter relies on this statement and purchases the machine. Upon discovering that the dealer's statement is false, Lindberg brings an action for breach of warranty. Is he entitled to judgment?

6. "One of the oldest rules of the common law is the maxim of caveat emptor." What is meant by this statement?

7. Samlow sells a set of carpenter tools to Hornbeck. It turns out that the tools belong to Holle who had possession of them at the time of the sale. Hornbeck brings an action against Samlow to recover damages for breach of warranty. Is he entitled to recover damages?

8. Clybourn buys a truck at a sale of the personal property of a deceased person. The truck is later taken from Clybourn by a finance company which holds a chattel mortgage on it. Clybourn brings an action for damages for breach of warranty against the administrator. Is he entitled to judgment?

9. Lundt orders a given quantity of leather of a grade known as ordinary. He intends to use the material in making hand luggage, but he discovers that it is not suitable for that purpose. Lundt brings an action against the vendor for damages arising out of a breach of warranty. Is he entitled to judgment?

10. Perrin went to Eshelman's store and inquired for strip-leaf, red-top turnip seed. The latter sold him seed which was presumably the kind requested. Perrin sowed the seed, and the crop turned out to be turnips of a different kind. Perrin brought an action for breach of warranty. Was he entitled to judgment?

11. McRae sold by sample a number of hams to Whitney. It was discovered later that because of the process used by McRae in curing the pork, the goods spoiled and became unmerchantable. Whitney brought an action for damages for breach of warranty. McRae proved that the goods delivered conformed to the sample. Was this a valid defense?

12. Manloff claims that goods sent by Travers do not correspond to the description and refuses to accept the goods. The latter contends that Manloff must accept the goods and that his only remedy is an action for damages arising out of breach of contract. Is his contention sound?

Part IV—Transfer of Title

When Title Passes. One of the most important questions in connection with a sale or a contract to sell relates to the time of transferring property in the goods. After the agreement has been made, the subject matter may be lost, stolen, or destroyed, in which case the loss will usually fall upon the party who has title to or ownership of the goods. The owner is also entitled to any increase in value or gain. It must be kept in mind that ownership does not depend upon possession; a person may own goods which are not in his possession, and he may possess goods which he does not own.

Unascertained Goods. Under a contract to sell unascertained goods, title or property in them does not pass until they are ascertained. To illustrate, a person agrees to sell to another five horses from his herd which vary in value and quality. Later a creditor of the seller levies an attachment on the herd, and the buyer claims that five of the horses belong to him. His contention is unsound, because title to the specific horses could not pass until they were ascertained.[1]

> Under an agreement to supply building materials, no title passed when no specific goods were "set aside, or determined upon." (Botsford Lumber Co. v. Schreiber, 49 N. D. 68, 206 N. W. 423)

Fungible Goods. " 'Fungible goods' means goods of which any unit is from its nature or by mercantile usage treated as the equivalent of any other unit." [2] If a buyer purchases an undivided share of a mass of fungible goods, such as coal or ice, some states hold that title does not pass until the quantity is determined. On the other hand, many states hold that title to an undivided share passes to the buyer without determination as to quantity, and the buyer becomes an owner in common with the seller. By way of illustration, a person sells to another six hundred bushels of wheat from his bin which contains one thousand bushels. Title to the undivided share of six hundred bushels passes to the buyer at the time of the

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[1] *Staubli* v. *Bank*, 11 Wash. 426, 39 P. 14.
[2] *Sales Act*, §76.

sale.[3] The Sales Act, adopting this latter rule, states: "In the case of fungible goods, there may be a sale of an undivided share of a specific mass, though the seller purports to sell and the buyer to buy a definite number, weight, or measure of the goods in the mass, and though the number, weight, or measure of the goods in the mass is undetermined. By such a sale the buyer becomes owner in common of such a share of the mass as the number, weight, or measure bought bears to the number, weight, or measure of the mass. If the mass contains less than the number, weight, or measure bought, the buyer becomes the owner of the whole mass, and the seller is bound to make good the deficiency from similar goods unless a contrary intent appears." [4]

> "It is sufficient that the parties in their agreement treated the hay as fungible goods, by making no reservation for selection from any part of the mass." (Cassinelli v. Humphrey Supply Co., 43 Nev. 208, 183 P. 523)

Ascertained Goods. It is uniformly held that under an agreement to sell ascertained goods, title passes at the time when the parties intend it to pass. Thus, if a person agrees to a present sale of a vehicle to another, although delivery is to be made on the following day, title passes at once in accordance with the intention of the parties.[5] The Sales Act states that "where there is a contract to sell specific or ascertained goods, the property in them is transferred to the buyer at such time as the parties to the contract intend it to be transferred." [6] It should be noted that, so far as the buyer and the seller are concerned, title to the goods may pass without delivery.

Ascertaining Intention. The parties do not always clearly indicate their intention as to when the property in the goods is to be transferred. In such cases courts must discover their intention as best they can. For the purpose of discovering the intent of the parties, courts have developed certain rules of construction. With the exception of the last one, the

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[3] *Kimberly* v. *Patchin*, 19 N. Y. 330.
[4] §6.
[5] *Winslow* v. *Leonard*, 24 Pa. 14.
[6] §18.

following rules which represent the existing general law are taken from the Sales Act: [7]

(1) "Where there is an unconditional contract to sell specific goods, in a deliverable state, the property in the goods passes to the buyer when the contract is made, and it is immaterial whether the time of payment or the time of delivery or both be postponed." Thus, when one person agrees to sell and another to buy the former's lawnmower, title passes at once, although the price has not been paid or the goods taken by the buyer.[8]

It was held that title to a tug frozen in ice passed at time of the agreement, the court stating: "We see no reason why the tug was not in a deliverable state." (Delaney v. Globe Shipbuilding Co., 175 Wis. 167, 184 N. W. 696)

(2) "Where there is a contract to sell specific goods and the seller is bound to do something to the goods, for the purpose of putting them into a deliverable state, the property does not pass until such thing is done." To illustrate, a person agrees to purchase a hog from another who agrees to fatten it. Title does not pass until the seller has performed the act promised.[9]

When a wrecking contractor agreed to sell steel beams in a building, and he was required to expose such beams for the buyer to remove them, title did not pass until this was done. (Stark v. Baird, 171 Wash. 651, 19 P. [2d] 105)

(3) "When goods are delivered to the buyer 'on sale or return,' or on other terms indicating an intention to make a present sale, but to give the buyer an option to return the goods instead of paying the price, the property passes to the buyer on delivery, but he may revest the property in the seller by returning or tendering the goods within the time fixed in the contract, or, if no time has been fixed, within a reasonable time." For example, a company sells a harvesting machine to a farmer, the terms of the agreement providing that the latter can return the machine within thirty days if he is not satisfied with it. If the machine is destroyed during this time and

[7] §19.
[8] *Thompson* v. *Brannin*, 94 Ky. 490, 21 S. W. 1057.
[9] *Restad* v. *Engemoen*, 65 Minn. 148, 67 N. W. 1146.

before it has been returned, the loss falls upon the buyer who has title.[10]

> The mere writing of a letter of rejection within the time fixed, instead of returning the goods, is not sufficient to avoid liability. (Columbia Weighing Mach. Co. v. Smith, 26 Ohio A. 321, 159 N. E. 855)

(4) "When the goods are delivered to the buyer on approval or on trial or on satisfaction, or other similar terms, the property therein passes to the buyer (a) when he signifies his approval or acceptance to the seller or does any other act adopting the transaction; (b) if he does not signify his approval or acceptance to the seller, but retains the goods without giving notice of rejection, then, if a time has been fixed for the return of the goods, on expiration of such time, and if no time has been fixed, on the expiration of a reasonable time." Under the common law many courts hold that the buyers' failure to return the goods within the time allowed is merely evidence of the buyer's acceptance of the goods. To illustrate, a person offered his horse to another for $200. The latter stated that if the former "would let him take the horse and try it, if he did not like it he would return it in as good condition as he got it, the night of the day he took it." The horse was not returned, and the seller sued for the price. The court held that failure to return was merely evidence of approval.[11]

> Under the Sales Act title passes upon retention of the goods without notice of rejection within the proper time. (Dinsmore v. Rice, 128 Md. 209, 97 A. 537)

(5) "Where there is a contract to sell unascertained or future goods by description, and goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller, the property in the goods thereupon passes to the buyer. Such assent may be expressed or implied, and may be given either before or after the appropriation is made." By way of illustration, when the

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[10] *Gay* v. *Dare*, 103 Calif. 454, 37 P. 466.
[11] *Hunt* v. *Wyman*, 100 Mass. 198.

seller at the order of the buyer set aside thirty bales of cotton marked as the buyer's, it was held that the seller was authorized to make the appropriation of the goods, passing title immediately to the buyer.[12]

> When the setting aside of goods by either party does not conform to the authority given, there is no appropriation passing title. (M. Shortell & Son v. Calnen, 102 Conn. 38, 128 A. 17)

(6) "Where, in pursuance of a contract of sale, the seller delivers the goods to the buyer, or to a carrier or other bailee (whether named by the buyer or not), for the purpose of transmission to or holding for the buyer, he is presumed to have unconditionally appropriated the goods to the contract, except in the cases provided for in the next rule and in section twenty. This presumption is applicable, although by the terms of the contract the buyer is to pay the price before receiving delivery of the goods, and the goods are marked with the words 'collect on delivery,' or their equivalent." Thus in the preceding illustration, if the buyer had directed the seller to send the bales of cotton to him, title would have passed upon delivery to the carrier as agent for the buyer.[13]

> Delivery of sixteen suits, instead of twelve as ordered, to a carrier, not being in compliance with the contract, does not constitute an appropriation passing title. (Smith, Fitzmaurice Co. v. Harris, 126 Me. 308, 138 A. 389)

(7) "If the contract to sell requires the seller to deliver the goods to the buyer, or at a particular place, or to pay the freight or cost of transportation to the buyer, or to a particular place, the property does not pass until the goods have been delivered to the buyer or have reached the place agreed upon." Thus, if a buyer orders a windmill from a dealer in Chicago to be sent to him f.o.b. Topeka, Kansas, title passes to the buyer when the goods reach that city.[14]

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[12] *Tift* v. *Wright & Weslosky Co.*, 113 Ga. 681, 39 S. E. 503.
[13] *Hobert* v. *Littlefield*, 13 R. I. 341.
[14] *Hunter Bros. Milling Co.* v. *Kramer Bros.*, 71 Kans. 468, 80 P. 963.

When the seller was required to deliver forty-seven coils of rope to the buyer in Baltimore, and to pay the freight, title did not pass upon delivery to the carrier. (Rylance v. James Walker Co., 129 Md. 475, 99 A. 597)

(8) If something remains to be done to the goods by the seller, the buyer, or both in collaboration, in order to determine the price, it is held in some states that title does not pass until that act is performed. The Sales Act does not contain this rule. Other states apply this rule only when the act in question is to be done by the seller alone or by both. This rule, like the other rules, is not applicable if a contrary intention is shown. Thus, when goods are to be measured or weighed to determine the price, title passes before the act is performed, when delivery has been made.[15]

Fraud. As between the buyer and the seller, a sale induced by fraud is voidable at the election of the innocent party. The nature of fraud has been discussed previously.[16] It is sufficient here to state that fraud is the false representation of a fact made knowingly or without regard to the truth, with the intention that it be acted upon, and is actually acted upon by the other party. When a sale has been induced by fraud, the innocent party, after learning of such fraud, may either affirm or rescind the agreement.[17]

Fraud may also take the form of an affirmative act likely or intended to prevent the knowledge of a fact or of a nondisclosure of facts when under a duty to disclose such fact. (Restatement, Contracts, Sec. 471)

Affirmance. Affirmance may be express or it may be implied by conduct indicating the seller's intention to treat the contract as binding. For example, if the buyer, with knowledge of the seller's fraud, sells the subject matter to another, he affirms the agreement.[18] If the defrauded party affirms the contract, he may recover damages in an action of deceit, or he may rely on the fraud as basis for recoupment of dam-

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[15] *Upson* v. *Holmes*, 51 Conn. 500.

[16] *Ante*, p. 78.

[17] The seller cannot avoid a sale procured by fraud as against a bona fide purchaser from the fraudulent vendee. *Post*, p. 583.

[18] *Bridgeford* v. *Adams*, 45 Ark. 136.

ages if an action is brought against him on the contract for the purchase price. Thus a buyer, having been induced by false representation to purchase an option for stock and having paid $1,000 of the $1,500 due on the contract, may use the fraud to reduce the claim of the seller in an action for the purchase price.[19]

> The uniform law does not deal with the effect of fraud, but expressly provides that "the rules of law and equity, including the law merchant," shall continue to apply. (Sales Act, Sec. 73)

Rescission. The defrauded party may rescind a contract induced by fraud. Notice of intention to repudiate the transaction must be given to the other party within a reasonable time after knowledge of the fraud. Furthermore, to constitute a valid rescission, an equitable rule requires that when either the price or the goods have been received, an offer to return, or a return of, the goods must be made. In a few instances, however, neither is necessary. For example, a wholesale carpet dealer was induced by fraud to sell carpets to the value of $1,882 to a retail dealer who made a part payment of $959. Because the buyer had disposed of an amount of the goods equaling the payment, the seller was not required to tender the money paid upon rescission.[20]

> Though the sale of an automobile is induced by fraud, the legal title "nevertheless passes to the purchaser or purported purchaser thereof and remains vested in him until such transaction is avoided or set aside." (Fuller v. Wright [Tex. Civ. A.], 82 S. W. [2d] 179)

When the buyer is defrauded, he may refuse to accept the goods, if the fraud is known before delivery; or he may return them, if it is discovered later. In either case he may recover the purchase price when it has been paid in advance. When the seller is defrauded, he may refuse to deliver the goods, or recover their possession if the fraud is discovered subsequent to delivery, unless they have passed into the hands of a bona fide purchaser. Whether buyer or seller, the defrauded party may use the rescission as a defense to an action on the contract.

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[19] *Rumsey* v. *Shaw*, 212 Pa. 576, 61 A. 1109.
[20] *Sloane* v. *Shiffer*, 156 Pa. 65, 27 A. 69.

Reservation of Right of Possession or Property. It frequently happens under a contract to sell specific or unascertained goods that the seller wishes to retain ownership in, or control over, the property until the fulfillment of certain conditions. "The right of possession or property may be thus reserved notwithstanding the delivery of the goods to the buyer or to a carrier or other bailee for the purpose of transmission to the buyer." [21] The reservation may be expressly made by the terms of the contract or by the method of appropriation. The rule previously stated, providing that when goods are appropriated or delivered to a carrier, title passes to the buyer, may be rebutted by the terms of the appropriation. The usual way of doing this is by use of the bill of lading. Certain rules have been developed in respect to the right of possession or property based upon the terms of the appropriation. These rules, however, may be rebutted by showing a contrary intention on the part of the seller. The existing law has, in the main, been codified by the Sales Act, the provisions of which are: [22]

(1) "Where goods are shipped, and by bill of lading the goods are deliverable to the seller or his agent, or to the order of the seller or of his agent, the seller thereby reserves the property in the goods. But if, except for the form of the bill of lading, the property would have passed to the buyer on shipment of the goods, the seller's property in the goods shall be deemed to be only for the purpose of securing performance by the buyer of his obligations under the contract."

> When goods are delivered to the buyer or to a bailee for the buyer, and the seller retains title merely as security, "the goods are at the buyer's risk from the time of such delivery." (Sales Act, Sec. 22-a)

(2) "Where goods are shipped, and by the bill of lading the goods are deliverable to the order of the buyer or his agent, but the possession of the bill of lading is retained by the seller or his agent, the seller thereby reserves a right to the possession of the goods, as against the buyer."

(3) "Where the seller of goods draws on the buyer for the price and transmits the bill of exchange and bill of lading to-

[21] *Sales Act*, §20—(1).
[22] §20—(2), (3), (4).

gether to the buyer to secure acceptance or payment of the bill of exchange, the buyer is bound to return the bill of lading if he does not honor the bill of exchange, and if he wrongfully retains the bill of lading he acquires no added right thereby."

Another method of reserving title is by means of a conditional sale. A *conditional sale* means any contract for the sale of goods under which possession is delivered to the buyer and the title is to vest in the buyer at a subsequent time upon payment of all or part of the purchase price, upon the performance of any other condition, or upon the happening of any contingency.[23] If the buyer defaults in the payment of any sum due or in the performance of any other condition, the seller may retake the goods.[24] Contrary to the rule in some states, the Uniform Conditional Sales Act requires that the seller sell the goods which he has retaken.[25] The proceeds of the resale are applied to the payment of expenses and then to the payment of the remainder of the purchase price due under the contract, after which any sum in excess thereof must be turned over to the buyer.[26]

As to the True Owner. As a general rule, one cannot sell a chattel which he does not own. When one attempts to do so, the title of the owner is not ordinarily disturbed, for, generally speaking, a buyer secures no better title than is possessed by the party who purports to sell.[27] Thus, if a thief steals a watch and sells it to another, the latter secures no title and is liable to the owner for conversion of the goods.[28] Under certain circumstances, however, a person who does not own goods can pass a better title than he possesses.

By Consent. The owner may expressly or impliedly authorize another to sell goods for him.[29] In this case the agent can pass title to goods which he does not own.

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[23] *Uniform Conditional Sales Act*, §1.
[24] *Uniform Conditional Sales Act*, §16.
[25] *Ibid.*, §19.
[26] *Ibid.*, §21.
[27] *Sales Act*, §23—(1).
[28] *Courtis* v. *Cane*, 32 Vt. 232.
[29] *Ante*, p. 176.

Estoppel. A person may by his conduct be estopped to deny the right or authority of another person to sell goods of the former. For example, a person buys a horse and has the bill of sale made out in the name of a friend to whom he gives possession of the animal and the bill of sale. The friend can sell the horse to a bona fide purchaser and give a valid title.[30]

Documents of Title. States have conflicting decisions as to whether one having possession of a negotiable bill of lading can give a good title to a bona fide purchaser. The Sales Act adopts the view that a good title is acquired by a bona fide purchaser to whom is negotiated a document of title issued by a carrier, warehouseman, or other bailee.[31]

Statutes and Powers. Under legislation, such as recording acts and factors' acts, under special common-law or statutory powers, and under order of a court, one may often give good title to goods as against the owner. To illustrate, in the event of a default by the pledgor, a pledgee has the common-law power to sell the pledged articles.[32]

As to Subsequent Vendee. It has been noted that usually a buyer takes no better title than is possessed by the seller. There are a few instances, however, in which a subsequent vendee will secure a title which is good as against either the original seller or the first buyer.

Voidable Title. As indicated in an earlier section, fraud on the part of the buyer renders his title to the goods voidable at the option of the seller. This rule is modified, however, in favor of a bona fide purchaser of the goods from the first buyer.[33] One who purchases them for value and without notice of the fraud, before the seller has rescinded the sale, secures a good title to the goods. To illustrate, the defendant was induced by fraud to sell a colt to Chandler who disposed of it to the plaintiff, a bona fide purchaser before the defendant disaffirmed the contract. The defendant took the colt from the

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[30] *Nixon* v. *Brown*, 57 N. H. 34.
[31] §§27-33.
[32] *Sales Act*, §23—(2); *Ante*, p. 482.
[33] *Sales Act*, §24.

plaintiff who then brought an action for conversion. The defendant was held liable for damages.[34]

Goods Left with Seller. Delivery is not necessary as between the seller and buyer, but in some instances it is as against subsequent vendees. Retention of the goods by the seller undoubtedly opens the way to fraud. Most states hold that retention of possession is only prima facie evidence of fraud which may be rebutted. Other states, however, hold that it is conclusive evidence of fraud, the absence of which cannot be shown to defeat the title of a subsequent vendee. The Sales Act states that "where a person having sold goods continues in possession of the goods, or of negotiable documents of title to the goods, the delivery or transfer by that person or by an agent acting for him, of the goods or documents of title under any sale, pledge, or other disposition thereof, to any person receiving and paying value for the same in good faith and without notice of the previous sale, shall have the same effect as if the person making the delivery or transfer were expressly authorized by the owner of the goods to make the same." [35]

> When the first buyer obtains possession of furniture after his seller with whom he left the goods had sold them to another, the second buyer has no claim to the goods. (Patchin v. Rowell, 86 Conn. 372, 85 A. 521)

Reservation of Title. As a general rule, in the absence of statute, when the seller reserves the title until the happening of a certain event, the so-called buyer (who is really only a bailee) cannot pass title to a subsequent purchaser. In some states, however, it is held that a bona fide purchaser secures a good title as against the original seller. Many states have statutes regulating such sales, requiring them to be written and filed or recorded in order to be valid against a purchaser without notice.[36]

As to Creditors. There are also a few situations in which a creditor can secure good title from one who does not own the goods.

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[34] *Kingsbury* v. *Smith*, 13 N. H. 109.
[35] §25.
[36] *Uniform Conditional Sales Act*, §5.

Reserving Title. When the seller reserves the title to goods, the rights of the creditors of the buyer who levy an execution on such goods are practically the same as those of a subsequent purchaser. Courts in a few states protect the creditor. Many states by statute protect the creditor, unless the contract of sale is filed or recorded in order to be valid as against attaching creditors or creditors obtaining a lien on the goods who do not have notice.[37]

> The statutory provisions vary in detail. For example, some statutes protect creditors generally; others protect only subsequent creditors. (Uniform Laws Annotated, vol. 2A, page 69, note 53)

Goods Left with Seller. Most states, following an old English statute, have enacted legislation providing that sales in fraud of creditors are void. Courts differ as to whether retention of the goods by the seller constitutes fraud. It is generally held that it is only prima facie evidence of fraud upon subsequent creditors, but some courts hold it to be conclusive evidence of fraud. The Sales Act leaves this question to local law, declaring that "where a person having sold goods continues in possession of the goods, or of negotiable documents of title to the goods, and such retention is fraudulent under any rule of law, a creditor or creditors of the seller may treat the sale as void." [38]

QUESTIONS

1. Brumund and Kainer enter into a contract of sale for ten sheep out of the latter's flock. When Brumund goes for the sheep on the following day, he learns that the entire flock had been sold to Letelt who took them away. Brumund sues Letelt for conversion of ten sheep which he alleges belonged to him. Is he entitled to judgment?

2. Sadock had thirty tons of coal in a bin and sold ten tons from the mass to Losacco. Before the latter called for the quantity he purchased, the entire bin of coal was destroyed by fire without the fault of either Sadock or Losacco. When sued for the purchase price, Losacco contended that Sadock had to suffer the entire loss. Was his contention sound?

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[37] *Uniform Conditional Sales Act*, §5.
[38] §26.

3. Flannery agrees to purchase a given quantity of cotton that the seller agrees to bale. The cotton is destroyed before it is baled. When the buyer refuses to pay for the cotton, the seller brings an action for the purchase price. The seller contends that the loss falls on the buyer. Do you agree?

4. Janik orders goods from Brookman on trial for thirty days. The goods are destroyed during this period. The seller brings an action for the price, contending that title to the goods is in Janik during this period, subject to the right of Janik to revest the title in Brookman by returning the goods. Do you agree?

5. Steffen, in Chicago, orders twelve barrels of flour from McCurdy, in Buffalo. The goods are marked C. O. D., pursuant to the agreement, and are delivered to the carrier. The goods are lost in transit. In an action brought by Steffen against McCurdy, it is contended that, as between these parties, Steffen must suffer the loss. Is this contention sound?

6. Fullerton delivered a truckload of coal to the St. Louis Oil Company under an agreement for the sale of the coal at $6.40 a ton. The oil company, under the agreement, was to weigh the coal to determine the price. Before the coal was weighed, a creditor of Fullerton attached the coal as the property of Fullerton. The oil company brought an action against the creditor, contending that the coal belonged to it. Do you agree?

7. Vogler agreed to sell certain pieces of very old furniture which he had on his farm for one hundred and fifty dollars. The furniture was worth much more than this price, because it was of a variety for which there was a large demand by collectors of antiques. Hitchcock knew of this fact but did not disclose it to Vogler. Vogler refused to perform on the ground of fraud. Hitchcock brought an action for damages. Was he entitled to judgment?

8. Reedy, in St. Louis, orders a given quantity of silk from Hartford, in Chicago. The latter ships the goods under a bill of lading, making them deliverable to the order of the buyer. Hartford retains the bill of lading in his possession. Creditors of Reedy attach the goods en route, contending that the goods belong to Reedy. Is their contention sound?

9. Asmus is induced by fraud to sell a harrow to Drumm who sells it to Lavick on the following day. Two days later Asmus learns of the fraud and disaffirms the contract. He now demands the harrow from Lavick. Is he entitled to recover it?

10. The Belding Company delivered a refrigerator to Ketchum under an agreement that title was to vest in the seller until the full purchase price had been paid. Before the price had been paid, Ketchum sold the article to Richards, who did not have notice of the reservation of title. The Belding Company brought an action to recover the refrigerator from Richards. Was the Belding Company entitled to judgment?

Part V—Rights and Duties of the Parties

Delivery. It is the seller's duty to transfer the possession of the goods to the buyer. The delivery must be made "in accordance with the terms of the contract, or sale." [1]

Place, Time, and Manner. The terms of the contract determine whether the seller is to send the goods or the buyer is to take possession of them. In the absence of a provision in the contract or usage of trade, the place of delivery is the seller's place of business, if he has one; otherwise it is his residence. If, however, the subject matter of the contract to sell or sale consists of specific goods which are known by the parties to be in some other place, this is the place of delivery.

If the seller is required to send the goods, but the agreement does not provide for the time of sending them, he must send the goods within a reasonable time. An effectual tender of delivery by the seller must be made at a reasonable hour. The same rule applies to a demand for possession of the goods by the buyer. What constitutes a reasonable hour is a question of fact to be determined in view of the circumstances of each case. The foregoing rules have been adopted by the Sales Act.[2]

> If the buyer of steel boiler tubes waives the requirement of delivery within a reasonable time, he cannot contend that a delivery not within such period was untimely. (A. B. Murray Co. v. Lidgerwood Mfg. Co., 241 N. Y. 455, 150 N. E. 514)

Quantity. The buyer has the right to insist that the proper quantity of goods be delivered. If the seller delivers a quantity of goods less than stipulated in the contract, the buyer may refuse to accept them. If the buyer accepts or retains the goods with knowledge of the seller's intention to deliver no more, he must pay for them at the contract price. If the goods are used or disposed of by the buyer before he learns of the seller's intention not to deliver more, the buyer is only required to pay the fair value of the goods.

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[1] *Sales Act*, §41.
[2] §43.

In a situation in which the seller delivers more than the quantity of goods stipulated in the contract, the buyer may do one of three things. First, he may reject the entire amount. Second, he may accept the goods which come within the terms of the contract and reject the rest. Third, he may accept all of the goods which the seller sends. In the last event, the buyer must pay for all of the goods at the contract price.

> The buyer of a quantity of 3 x 8 lumber may refuse to accept a tender of half the number of pieces of 6 x 8, which would have to be resawed. (Burrows & Kenyon v. Warren, 9 F. [2d] 1)

If the seller sends goods included in the contract mixed with goods of a different character, the buyer may reject all of the goods or he may accept the goods included in the contract and reject the rest. These rules, adopted by the Sales Act, are subject, however, "to any usage of trade, special agreement, or course of dealing between the parties." [3]

Installments. The buyer is under no obligation or duty to accept delivery of goods by installments unless the contract contemplates such deliveries. When the contract provides for delivery by installments, a difficult problem is presented when the seller fails to make a proper delivery or the buyer fails to pay for one or more installments. For example, a person agrees to sell six thousand tons of coal to another to be delivered in three equal monthly installments. During one month he delivered only one hundred and fifty tons. Some states hold that the buyer must accept the remaining installments, although he is entitled to damages for the deficiency in the first delivery.[4] Other states take the view that time is of the essence of such contracts, and that a failure to deliver or to pay a particular installment goes to the root of the contract, entitling the other party to rescind the entire transaction.[5] The Sales Act, adopting neither rule entirely, states that "where there is a contract to sell goods to be delivered by stated installments, which are to be separately paid for, and the seller

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[3] *Sales Act*, §44.
[4] *Myer* v. *Wheeler*, 65 Iowa 390, 21 N. W. 692.
[5] *Providence Coal Co.* v. *Coxe*, 19 R. I. 380, 35 A. 210.

makes defective deliveries in respect to one or more installments, or the buyer neglects or refuses to take delivery of or pay for one or more installments, it depends in each case on the terms of the contract and the circumstances of the case, whether the breach of contract is so material as to justify the injured party in refusing to proceed farther and suing for damages for breach of the entire contract, or whether the breach is severable, giving rise to a claim for compensation but not to a right to treat the whole contract as broken." [6]

> When payment is to be made for each installment, "the delivery of each installment and the payment for each installment are conditions precedent respectively to the respective duties to accept and to deliver a subsequent installment." (Restatement, Contracts, Sec. 272, Illus. 1)

Delivery to Carrier. When the seller undertakes to send the goods to the buyer, delivery to the carrier is usually considered delivery to the buyer, except as noted earlier. This rule does not apply, however, when the seller disobeys the instructions of the buyer or fails to use reasonable care in making safe delivery. To illustrate, a buyer in Sigourney orders plow castings from a manufacturer in Muscatine. The buyer does not receive the goods because they were improperly addressed by the seller. In such a case delivery to the carrier is not delivery to the buyer.[7] The Sales Act adopts this rule and also provides that "unless otherwise agreed, where goods are sent by the seller to the buyer under circumstances in which the seller knows or ought to know that it is usual to insure, the seller must give such notice to the buyer as may enable him to insure them during transit, and, if the seller fails to do so, the goods shall be at his risk during transit." [8]

Acceptance. It is the duty of the buyer to accept the goods. Acceptance may be shown in three ways.[9] First, there may be an express acceptance. In this case no particular form of words is necessary; it is sufficient if the buyer "intimates to the seller that he has accepted" the goods. Second,

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[6] §45—(2).
[7] *Garretson* v. *Selby*, 37 Iowa 529.
[8] §46—(3).
[9] *Sales Act*, §48.

the acceptance may be implied by the fact that the buyer retains the goods an unreasonable length of time without rejection. Third, acceptance may be implied by the fact that he exercises dominion over them as owner. For example, a person orders a ton of coal, and after delivery he sells it or part of it to his neighbor. This conduct is strong, if not conclusive, evidence of an acceptance.[10]

> A provision in a contract for the sale of machinery, stipulating that retention of the goods by the buyer after thirty days constitutes an acceptance, was held binding on the buyer. (Mechanics' Lumber Co. v. Yates American Mach. Co., 181 Ark. 415, 26 S. W. [2d] 80)

Right to Examine Goods. Unless the buyer waives inspection, he is considered not to have accepted the goods until he has had a reasonable opportunity to examine them for the purpose of determining whether they meet the requirements of the contract. Upon tender of delivery the buyer is entitled to request an opportunity to examine the goods. Courts take different views as to whether a C.O.D. shipment bars the right of inspection before payment is made. The Sales Act states that it does unless there is an agreement to the contrary.[11]

> If the buyer of sheep requested that the animals be "mouthed out," which was necessary to determine ages, and the seller insisted that the buyer take the sheep at "gate run," rejecting only the crippled and sick ones, there was a denial of the right of inspection, constituting "a failure of tender of delivery." (Crosland v. Sloan, 123 Oreg. 243, 261 P. 701)

Effect of Acceptance. There is a difference of opinion as to the effect of acceptance of the goods on the right of the buyer to claim damages for failure on the part of the seller to meet the terms of the contract. For example, if the seller is late in delivery or sends goods of an inferior quality, some courts hold that the buyer waives his right to complain by accepting the goods. Other courts, however, hold that there is no waiver. The Sales Act, adopting the latter view, states that "in the absence of the express or implied agreement of the

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[10] *Lenz* v. *Blake, McFall Co.*, 44 Oreg. 569, 76 P. 356.
[11] §47—(3).

parties, acceptance of the goods by the buyer shall not discharge the seller from liability in damages or other legal remedy for breach of any promise or warranty in the contract to sell or the sale. But, if, after acceptance of the goods, the buyer fails to give notice to the seller of the breach of any promise or warranty within a reasonable time after the buyer knows, or ought to know of such breach, the seller shall not be liable therefor." [12]

Payment. The buyer has not performed his part of the contract merely by accepting the goods. He is under the further duty to pay for them. In the absence of an agreement that payment must precede delivery, the buyer is under no duty to pay unless the seller is prepared to deliver. Thus, if a person buys a particular chattel from another, the latter cannot demand payment until he delivers or tenders delivery of the article.[13]

> The seller by giving credit waived the provision in the contract requiring the buyer to pay for ice as purchased. (Doup v. Nicholas, 182 Ark. 1185, 31 S. W. [2d] 138)

The buyer performs his duty in respect to payment by making a tender of the price. The essentials of a valid tender have already been discussed.[14] If the seller refuses a proper tender, the buyer is not discharged from the obligation to pay the price, but he cannot be held for interest thereafter or court costs if he is sued, provided his tender is continuous and the money is paid into court. The Sales Act defines an unpaid seller to be a seller of goods "(a) when the whole of the price has not been paid or tendered; (b) when a bill of exchange or other negotiable instrument has been received as conditional payment, and the condition on which it was received has been broken by reason of the dishonor of the instrument, the insolvency of the buyer, or otherwise." [15]

Lien. The unpaid seller who has not parted with the possession of goods has a lien on them. In other words, he has

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[12] §49.
[13] *Davis* v. *Gilliam*, 14 Wash. 206, 44 P. 119.
[14] *Ante*, p. 159.
[15] §52.

the "right to retain them for the price while he is in possession of them." [16] This right cannot, however, be exercised for the recovery of other claims. To illustrate, when the seller is put to some expense in taking care of the goods, he has no right to retain the goods as security for this claim.[17]

> A statutory purchase-money lien is sometimes given the seller while the goods remain "in the hands of the first purchaser, or of one deriving title or possession through him, with notice that the purchase money was unpaid." (Weiss, Dreyfous & Seiferth v. Natchez Inv. Co., 166 Minn. 253, 140 S. 736)

The seller, although in possession of the goods, is not always entitled to a lien on them. He may exercise the right to retain the goods under three conditions: (1) if the goods have been sold without stipulation as to credit; (2) if the goods have been sold on credit, but the term of the credit has expired; and (3) if the buyer becomes insolvent. The second and third rules provide for a revival of the lien which has been waived. To illustrate, when the seller extends credit to the buyer of certain goods, the seller has no right under the first rule to retain the goods. If, however, the buyer becomes insolvent, then the seller has a lien under the third rule.[18]

Termination of Lien. The seller has no right to retain the goods after payment or a valid tender is made. He may also lose his lien in other ways. The Sales Act, adopting existing law, provides that the lien is lost by the unpaid seller of goods "(1) when he delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer without reserving the property in the goods or possession thereof; (2) when the buyer or his agent lawfully obtains possession of the goods; and (3) when there is a waiver thereof." [19]

> When the seller of sand and gravel plant equipment "took security for the purchase price, he thereby waived his lien." (Bongiovanni v. Fickett, 122 Calif. A. 538, 10 P. [2d] 539)

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[16] *Sales Act*, §53—(1).
[17] *Putnam* v. *Glidden*, 159 Mass. 47, 34 N. E. 81.
[18] *Bohn Mfg. Co.* v. *Hynes*, 83 Wis. 388, 53 N. W. 684.
[19] §56.

The seller may expressly or impliedly waive his lien. By way of illustration, when the buyer is extended credit, the lien is waived by implication.[20] It is usually held that part delivery does not bar a lien on the remainder, unless such was the intention of the parties. This rule is adopted by the Sales Act.[21]

Stoppage in Transitu. After the unpaid seller has given the goods to the carrier, he still has the right of *stoppage in transitu.* This is a right to resume possession of the goods while in transit when the buyer, unknown to the seller, is insolvent at the time of the sale, or thereafter becomes insolvent. The seller then has the rights which existed before delivery to the carrier.[22] This right is sometimes described as an extension of the unpaid seller's lien. The seller is liable, however, if he stops the goods before the buyer becomes insolvent. The Sales Act defines insolvency as follows: "A person is insolvent, within the meaning of this act, who either has ceased to pay his debts as they become due, whether he has committed an act of bankruptcy or not, and whether he is insolvent within the meaning of the Federal Bankruptcy Act or not." [23]

> "The right of stoppage in transitu exists only in cases of insolvency of the purchaser discovered by the seller after sale and shipment." (Mercantile Bank & Trust Co. v. Schuhart, 115 Tex. 114, 277 S. W. 1087)

Except for the carrier's lien for transportation charges, the right of stoppage in transitu is superior to other claims. Thus, when the creditors of the buyer attach the goods en route, their claims are subject to the right of the seller.[24]

When in Transit. It is important to determine whether the goods are in transit, because it is only during this period that the seller has the right to resume possession of them. The goods are deemed to be in transit from the time they are placed in the hands of the carrier or a bailee for the purpose

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[20] *McCraw* v. *Gilmer*, 83 N. C. 162.
[21] §55.
[22] *Sales Act*, §57.
[23] §76—(3).
[24] *Calahan* v. *Babcock*, 21 Ohio St. 281.

of transmitting them to the buyer, until they are delivered to the latter or his agent. When the goods are delivered to a vessel chartered by the buyer, the goods may or may not be in transit, depending on whether they are in the possession of the master as a carrier or as agent of the buyer. Some states apply the same rule when the ship is owned by the buyer.

End of Transit. According to the provisions of the Sales Act which states the existing law, goods are not in transit under the following conditions: "(1) if the buyer, or his agent in that behalf, obtains delivery of the goods before their arrival at the appointed destination; (2) if, after the arrival of the goods at the appointed destination, the carrier or other bailee acknowledges to the buyer or his agent that he holds the goods on his behalf and continues in possession of them as bailee for the buyer or his agent; (3) if the carrier or other bailee wrongfully refuses to deliver the goods to the buyer or his agent in that behalf." [25]

> After gasoline had been delivered to the buyer, the seller was precluded from exercising the right of stoppage in transitu. (Henderson v. Webster, 178 Ark. 553, 11 S. W. [2d] 463)

It may happen that part of the goods has been delivered before the seller attempts to exercise his right of stoppage. In such a case he may resume possession of the remainder, except when the delivery of a part may be treated as a delivery of the whole of the goods.

Exercising the Right. The right of the unpaid seller to resume possession of the goods may be exercised in one of three ways: first, he may obtain actual possession of the goods; second, he may give notice to the person in actual possession; third, he may give notice to the principal of the person in actual possession. In the last-mentioned case the notice must be given so that the principal can prevent delivery by acting with reasonable diligence. These rules have been adopted by the Sales Act.[26]

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[25] §59—(2).
[26] §59.

> The right of stoppage in transitu "may be exercised by any person who, as between himself and the buyer, may be considered as an unpaid seller." (Weyerhouser Timber Co. v. First Nat. Bank, 150 Oreg. 172, 38 P. [2d] 48)

After proper notice has been given, the bailee must follow the instructions of the seller as to the disposal of the goods. When a negotiable document of title for the goods is in circulation, however, he is not obliged to do so until the document is surrendered. The holder of such a document may defeat the seller's right of stoppage. The Sales Act states that if "a negotiable document of title has been issued for the goods, no seller's lien or right of stoppage in transitu shall defeat the right of any purchaser for value in good faith to whom such document has been negotiated, whether such negotiation be prior or subsequent to the notification to the carrier or other bailee who issued such document, of the seller's claim to a lien or right of stoppage in transitu." [27]

Resale. Another right of the unpaid seller against the goods is the right to resell the goods. It is sometimes said that the seller disposes of the goods under these circumstances as an agent of the buyer by necessity or by law, but it seems that the seller is really acting for himself.

> A resale "is in the nature of a foreclosure of a lien held to secure the payment of the purchase price." (Urbansky v. Kutinsky, 86 Conn. 22, 84 A. 317)

An unpaid seller, having the right of lien or having stopped the goods in transitu, may resell the goods, first, if the right of resale is expressly reserved in case the buyer should make default; second, if the goods are of a perishable nature; or, third, if the buyer has been in default in payment of the price an unreasonable length of time. A sale by the seller under any of these circumstances gives good title to the buyer as against the original buyer. After the sale the seller is not liable to the buyer upon the contract or for any profit made by the resale, as when the proceeds of the resale are greater than the contract price. On the other hand, if the proceeds are less than the contract price, the seller may recover the loss from the original buyer.

[27] §62.

"A reasonable time after default must elapse" before resale by the seller. (Atlantic City Tire & Rubber Corp. v. Southwark F. & M. Co., 289 Pa. St. 569, 137 A. 807)

It has been held in some states that notice of intention to exercise the right of resale should be given to the buyer, except when circumstances make it inadvisable, as when the goods are of a perishable nature. Other states adopt the view that notice is unnecessary. The Sales Act states that "it is not essential to the validity of a resale that notice of an intention to resell the goods be given by the seller to the original buyer. But where the right to resell is not based on the perishable nature of the goods or upon an express provision of the contract or sale, the giving or failure to give notice shall be relevant in any issue involving the question whether the buyer had been in default an unreasonable time before such resale was made." [28]

Remedies of the Seller. If the buyer fails to perform his part of the contract, the seller may select one of several remedies.

Action for the Price. When the ownership of goods has passed, the seller may maintain an action for the price against the buyer if the latter wrongfully neglects or refuses to pay for the goods, unless payment is not due under the terms of the agreement. In some instances an action may be maintained for the price when title has not passed. To illustrate, a buyer agrees to pay $50 on January 1 for the seller's watch, and the latter agrees to transfer it to him one month later. The seller under these circumstances is entitled to sue for the price even though ownership of the watch has not passed.[29] This is not true, however, when the seller gives evidence of inability or of an intention not to fulfill his part of the agreement. When the price is due only upon the transfer of ownership, and the buyer refuses to accept the goods, it seems that the seller should not be allowed to sue for the price, but only for damages. This view is taken by some courts. On the other hand, some courts allow an action for the price under

[28] §60.
[29] *White* v. *Solomon*, 164 Mass. 516, 42 N. E. 104.

such circumstances. Other courts allow an action for the price only when the goods cannot readily be resold for a reasonable price. The latter view is adopted by the Sales Act.[30]

> When title has passed and the buyer fails to pay, "the measure of damages is the purchase price of the goods." (Higgins v. California Prune & Apricot Growers, 16 F. [2d] 190)

Action for Damages. When the buyer wrongfully refuses or neglects to accept and pay for the goods, the seller may maintain an action for damages. The measure of damages is usually the difference between the contract price and the market price at the time and place of delivery. The Sales Act states that "the measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events from the buyer's breach of contract." [31] In the event of repudiation by the buyer before time for performance by the seller, the latter may sue at once. If, however, the seller does not elect to sue at once, he cannot continue performance so as to increase his damages.

> The sellers of hay could only recover nominal damages upon breach of the buyer, if they could easily have sold the hay for $2 a ton more than the contract price. (Zimmerman v. Grover, 55 S. D. 105, 225 N. W. 59)

Rescission of the Sale. Another remedy of the seller who is in possession of the goods is the right of rescission. A provision in the Sales Act gives the seller in possession the right to rescind by giving notice thereof, first, when there is a repudiation of the agreement by the buyer; second, when the buyer indicates that he cannot perform his part; and, third, when the buyer fails to perform a material part of his obligation.[32] Another provision in the Sales Act gives the unpaid seller with a lien on the goods the right to rescind "where he expressly reserved the right to do so in case the buyer should make default or where the buyer has been in default in payment of the price an unreasonable time." [33]

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[30] §63.
[31] §64—(2).
[32] §65.
[33] §61—(1).

Remedies of the Buyer. If the seller fails to perform his obligation, the buyer also has one or more remedies, depending upon the nature of the default. The default of the seller may be in respect to the delivery of the goods, or in respect to defects in the goods delivered. The remedies in connection with the latter have been considered under an earlier topic.[34]

Action in Tort. When, as a result of the agreement, ownership passes to the buyer, and the seller wrongfully refuses or neglects to deliver the goods, "the buyer may maintain any action allowed by law to the owner of goods of similar kind when wrongfully converted or withheld." [35] Hence the buyer, having the right to immediate possession, may bring an action of replevin to recover the goods wrongfully withheld, or may bring an action to recover the value of the goods on the ground of conversion.

> In a cash sale title does not pass until payment of the price; hence until payment thereof the buyer cannot sue for possession of the goods. (Estern Seed Marketing Co. v. Pfort, 45 Ida. 340, 262 P. 514)

Action for Damages. If the ownership of the goods has not passed to the buyer, and the seller wrongfully refuses or neglects to deliver the goods, the buyer is entitled to bring an action to recover damages for nondelivery. The measure of damages is ordinarily the difference between the contract price and the market price at the time and place of delivery. The Sales Act states that "the measure of damages is the loss directly and naturally resulting in the ordinary course of events from the seller's breach of contract." [36] If there is no actual loss, the buyer is entitled to recover nominal damages. In some instances the buyer is entitled to special damages. By way of illustration, when the seller knows that the subject matter of the sale is to be used to preserve other goods, he is liable for the destruction of such goods because of his failure to comply with his agreement.[37] The buyer is under

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[34] *Ante*, p. 571.
[35] *Sales Act*, §66.
[36] §67—(2).
[37] *Hammer* v. *Schoenfelder*, 47 Wis. 455, 2 N. W. 1129.

a duty in all cases to mitigate his damages. For example, when the seller fails to perform his promise by nondelivery, if the buyer has the opportunity to purchase the goods for less than the market price, he must do so.[38]

Rescission of the Contract. When a failure of the seller to perform amounts to a material breach, the buyer may rescind the contract. In such case the buyer is entitled to the return of any purchase money paid under the contract.

> Rescission and an action for breach of contract are inconsistent remedies; hence a buyer cannot rescind the contract and later sue for damages. He cannot "both affirm and rescind the contract." (Talcott v. Slater Bros. Cloak & Suit Co., 171 App. Div. 395, 157 N. Y. S. 499)

Specific Performance. Contracts to sell personal property are rarely enforced specifically by courts of equity, because the remedies at common law for the breach of such contracts are considered adequate in most cases.[39] In a few instances, however, specific performance is granted to the buyer when damages would not be adequate compensation or could not be fairly determined. To illustrate, if the seller refuses to deliver particular certificates of stock which cannot be secured in the market, the buyer may obtain specific performance in equity.[40] The Sales Act provides for specific performance on application of the buyer at the discretion of the court of equity.[41]

QUESTIONS

1. Donovan entered into an agreement with Joslyn to sell a piano that was stored in the Fir-Pruf Warehouse. Thereafter Joslyn refused to pay the purchase price on the ground that Donovan failed to deliver the piano at Joslyn's residence. Donovan brought an action against Joslyn to recover damages. Was he entitled to judgment?

2. A seller delivers one hundred barrels of syrup over and above the amount ordered by the buyer. The entire quantity is accepted. The buyer refuses, however, to pay more than the market price for the excess quantity. The seller brings an action to recover payment for the excess amount at the contract price. Is he entitled to judgment?

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[38] *Lawrence* v. *Porter*, 63 F. 62.
[39] *Ante*, p. 162.
[40] *Williams* v. *Montgomery*, 148 N. Y. 519, 43 N. E. 57.
[41] §68.

3. Skibbens agreed to purchase five thousand tons of iron rails from Linkon. The latter agreed to ship the rails from Europe to Philadelphia at the rate of one thousand tons a month. During the first month the seller shipped only four hundred tons, and Skibbens gave notice that he rescinded the agreement. The seller brought an action for breach of contract. Was he entitled to judgment?

4. Fager delivers twelve crates of canned tomatoes to Fullerton who sells one crate to Galinsky. Later Fullerton refuses to pay for the goods on the ground that they are of inferior quality and contends that he had not accepted the goods. Fager brings an action against Fullerton to recover the purchase price. Is Fager entitled to judgment?

5. Spear sells and delivers certain goods to Faberson. At a later date Faberson offers to pay the sum of one hundred dollars, which Spear refuses on the ground that it is not the agreed price. In an action by Spear to recover the price of the goods, Faberson proves that he made a valid tender of the agreed amount. Is Spear entitled to a judgment for the sum of $100?

6. Eadle sells one hundred reams of paper to Scanlan. The agreement provides for eighteen days' credit. Twenty days later Scanlan demands the goods. Eadle refuses to make delivery until he is paid. Scanlan brings an action to recover the goods. Is he entitled to judgment?

7. Kinney orders certain goods from Thompson who delivers them to a carrier. The bill of lading making the goods deliverable to the order of Kinney is purchased in good faith for value by Peck. Kinney becomes insolvent, and Thompson notifies the carrier to stop delivery the day before the bill is negotiated to Peck. The carrier then delivers the goods to Peck upon demand. Thompson brings an action for damages against the carrier. Is he entitled to judgment?

8. Burnette sells a grindstone to Cudahy but refuses to make delivery until he is paid. Cudahy fails to pay for the article, and Burnette sells it two months later. In an action by Burnette to recover the difference between the amount of the resale and the purchase price, Cudahy contends that the sale of the goods by Burnette had not been properly made because he had not been notified. Do you agree with this contention?

9. Chandler directs Fidler to make a chair of a special design to set in a particular corner of the former's house. When the chair is completed, Chandler refuses to accept it. Fidler brings an action for the price. Chandler contends that he is liable only for damages arising out of the breach of contract. Is his contention sound?

10. McPhail sold a vacuum sweeper to Henry Gerry. Delivery was to be made on the following Thursday, whereas payment was to be made on the day preceding delivery. When Gerry failed to pay as agreed, McPhail notified Gerry that he rescinded the sale. Thereafter, when McPhail refused to deliver the goods upon tender of payment, Gerry brought an action to recover damages. Was Gerry entitled to judgment?

CASES FOR REVIEW

1. The American Peanut Corporation agreed to sell a carload of peanuts to Birdsong & Company. The goods were shipped from Norfolk, Virginia, to Philadelphia, Pennsylvania. Thereafter the American Peanut Corporation brought an action against Birdsong & Company to recover the price of the goods. Birdsong & Company, as a defense, alleged that title to the goods had not passed. Assuming the allegation to be true, was the American Peanut Corporation entitled to judgment? (Birdsong & Co. v. American Peanut Corporation, 149 Va. 755, 141 S. E. 759)

2. Granville A. Beals was engaged in the manufacture of woolen cloth in East Greenwich, Rhode Island, under the trade name of Greenwich Mills. He agreed to sell to Michael Hirsch 285 pieces of cloth of 60 yards to the piece at $3.95 a yard. Delivery was tendered by Beals of cloth of 50 to 53 yards to the piece. When Hirsch refused to accept and pay for the goods, Beals brought an action against Hirsch to recover damages for breach of contract. Was Beals entitled to judgment? (Beals v. Hirsch, 214 App. Div. 86, 211 N. Y. S. 293)

3. The Davis & Andrews Company was engaged in a milling and wholesale business in Memphis, Tennessee. It sold by description certain grain to D. Rosenblum's Sons, retail dealers in the state of Mississippi. Part of the grain delivered by the seller was unsalable because of being wet and decayed. In an action brought by the seller against the buyer, it was contended that there was a breach of warranty on the part of the seller. Was this contention sound? (D. Rosenblum's Sons v. Davis & Andrews Co., 111 Miss. 278, 71 S. 388)

4. John De Nunzio and another entered into an oral agreement whereby they promised to buy thirty-three shares of stock of the De Nunzio Company, Incorporated, from Frank A. De Nunzio. The agreed price was the sum of $550, which amounted to more than the sum specified in the Statute of Frauds. In an action brought by the seller against the buyers to recover the purchase price, it was contended that the transaction was not a sale within the meaning of the Statute of Frauds. Do you agree? (De Nunzio v. De Nunzio, 90 Conn. 342, 97 A. 323)

5. R. E. L. Brown alleged that he had made a contract with John Sheedy, of Benton County, Oregon, whereby Sheedy had agreed to sell to him eighty-seven head of cattle. When Sheedy refused to deliver the animals, Brown brought an action against Sheedy to recover possession of the cattle. Assuming that the allegation was proved, was Brown entitled to judgment? (Brown v. Sheedy, 90 Oreg. 74, 175 P. 613)

6. Rhea G. Price and Hamilton entered into an agreement to purchase two bargeloads of new slack coal from Fox Brown. The coal was delivered on barges of the buyers on Green River at or near Mining City, Kentucky, in accordance with the agreement. The buyers, after

being given an opportunity to inspect the coal, hooked onto the barges and transported them up the river to Bowling Green, several miles away. During subsequent litigation the buyers contended that they had not accepted the coal. Do you agree? (Brown v. Price, 207 Ky. 8, 268 S. W. 590)

7. Freeling Fox and another were partners engaged in the farm machinery business in Platteville, Wisconsin. In the course of their business they sold a tractor to Edward Boldt. Thereafter Boldt alleged that there was a breach of warranty. An action was brought by the seller against Boldt to recover the purchase price. The partners contended that Boldt had accepted the machine; hence he could not rescind the agreement. If the contention was true, was Boldt without any defense to the action? (Fox v. Boldt, 172 Wis. 333, 178 N. W. 467)

8. Willard T. Beedy and another entered into an oral agreement whereby they agreed to sell a quantity of hay to the Brayman Wooden Ware Company. The price was over the minimum specified in the Statute of Frauds. There was no memorandum of the transaction, no payment, and nothing given in earnest, but the hay was delivered. The company discontinued its lumbering operations and offered to sell the hay to Beal, who refused the offer. When sued by the seller to recover the purchase price, the company pleaded the Statute of Frauds. Was the seller entitled to judgment? (Beedy v. Brayman Wooden Ware Co., 108 Me. 200, 79 A. 721)

9. Schuster, Hingston & Company, of St. Joseph, Missouri, sold certain goods on credit to A. Sands. The goods were shipped to Geneva, Nebraska, over the Chicago, Burlington & Quincy Railroad. Washington I. Carson, a creditor of Sands, attached the goods to satisfy his claim while the goods, after reaching their destination, were in the warehouse of the carrier awaiting delivery. In an action brought by the seller against Carson, it was contended that the right of the seller to stop the goods in transit had been lost. Do you agree? (Schuster v. Carson, 28 Neb. 612, 44 N. W. 734)

10. Annie E. Lawrence retained on a homestead a quantity of wheat that she had sold to O. W. Perry, a merchant of Ovando, Montana. Thereafter certain creditors of Mrs. Lawrence attached the wheat, which was sold by the sheriff to satisfy their claims. The O. W. Perry Company, to whom Perry had transferred his interest, brought an action against Thomas Mullen, sheriff of Powell County, to recover damages for an alleged wrongful sale of its wheat. Was it entitled to judgment? (O. W. Perry Co. v. Mullen, 81 Mont. 482, 263 P. 976)

11. Francis B. W. Folsom contracted with the Boston Consolidated Gas Company for the purchase of "a four section Kane gas steam boiler." It turned out that the boiler did not supply sufficient steam and in other ways did not suit the purposes of the buyer. In an action brought by the company to recover the purchase price, Folsom contended that there was

a breach of warranty. Do you agree? (Boston Consol. Gas Co. v. Folsom, 213 Mass. 90, 130 N. E. 197)

12. Harry Goldshine, under the name of the Manes Company, was engaged in making and selling toy novelties, consisting of obscene and indecent devices. He sold and delivered a quantity of such products for the sum of $151.61 to Henry Glass. When Glass failed to pay for the goods, Goldshine brought an action against Glass to recover the purchase price. Was he entitled to judgment? (Manes Co. v. Glass, 41 R. I. 135, 102 A. 964)

13. The Youmans Lumber Company sold certain lumber to the Chilhowee Lumber Company. It shipped the goods from La Follette to Lenoir, Tennessee, but it stopped the goods and took possession thereof at the point of destination. The lumber was unloaded and placed upon the premises of J. W. Baugher. Agents of the buyer, by false representation and without the consent of the seller, obtained possession of the lumber from Baugher. In an action brought by creditors of the Chilhowee Lumber Company, the Youmans Lumber Company contended that it had an unpaid vendor's lien on the lumber. Do you agree? (McGill v. Chilhowee Lumber Co., 111 Tenn. 552, 82 S. W. 210)

14. Harry Lines and another entered into an agreement for the transfer of the title to thirty bags of Java sugar to the Burlington Grocery Company. The agreement provided merely that the price to be paid by the company should not be over 26¢ a pound. The sugar was delivered. Thereafter Lines brought an action against the company to recover on a contract of sale. It was contended that the transaction was not a sale. Do you agree? (Burlington Grocery Co. v. Lines, 96 Vt. 405, 120 A. 169)

15. Oscar Dreisbach entered into an agreement whereby he sold his interest in an orchestrion to Bewig. There was a mortgage on the instrument at the time of the sale. When Dreisbach brought an action against Mary Ecklekamp, as executrix of the estate of Bewig, to recover the unpaid purchase price, it was contended that there was a breach of an implied warranty. Was this contention sound? (Dreisbach v. Ecklekamp, 82 N. J. L. 726, 83 A. 175)

16. Anton Juno on February 23 sold a part of certain seed grain located in his granary. A few days later he filed a statutory lien to give him a lien on the crop produced from such seed. The lien had to be filed within thirty days after the title passed to the buyer. About the first of May following the agreement, the buyer took the grain from the granary. In an action brought by Juno against the Northland Elevator Company, it was contended that the lien had not been filed during the time specified by the statute. Do you agree? (Juno v. Northland Elevator Co., 56 N. D. 223, 216 N. W. 562)

17. M. L. Decker entered into a written contract whereby he promised to sell the Idlehour Theater in Paw Paw, Michigan, to Royal E.

Decker and Rule J. Crosbie upon the payment of the sum of $1,000. Thereafter in an action brought by M. L. Decker against George Pierce, it was contended that the foregoing transaction constituted a sale. Do you agree? (Decker v. Pierce, 191 Mich. 64, 157 N. W. 384)

18. The Brown & Lowe Company delivered a secondhand road machine to H. A. Potolski, who was engaged in road construction. Potolski took the machine under an agreement to try it out and to pay an agreed sum if the machine proved satisfactory. The machine was used under two road contracts for a period of one year and four months, after which Potolski claimed that it was unsatisfactory and refused to pay for it. The Brown & Lowe Company brought an action to recover the agreed price. Was it entitled to judgment? (Brown & Lowe Co. v. Potolski, 221 App. Div. 299, 223 N. Y. S. 71)

19. The Bridal Veil Box Factory, of Bridal Veil, Oregon, entered into an oral agreement with A. A. Courtney, whereby it agreed to manufacture fifty thousand oil cases according to specifications differing from the standard regulation cases usually made and kept on hand by the company. The price was over the amount stated in the Statute of Frauds. No memorandum of the transaction was made and no money was paid in earnest or in part payment. When the company failed to perform as agreed, Courtney brought an action to recover damages. Was he entitled to judgment? (Courtney v. Bridal Veil Box Factory, 55 Oreg. 210, 105 P. 896)

20. Gregorio and Johanna Di Lorenzio were in possession of certain goods that belonged to Pauline Wolf, a dealer in household furniture. After the goods were destroyed by fire, an agreement for the payment of a specified sum for such goods was made between the parties. In an action brought by the dealer against the Di Lorenzios, it was contended that the agreement constituted a sale. Do you agree? (Wolf v. Di Lorenzio, 22 Misc. Rep. 323, 49 N. Y. S. 191)

21. George A. Learned offered to sell two lots of shoes to Al A. Rosenbush and others, dealers in shoes at wholesale. He described the goods as "prime elegant merchandise." The offer was accepted by the dealers, who later found that the shoes were defective. Thereafter the buyers brought an action against Learned to recover for a breach of an express warranty. Were they entitled to judgment? (Rosenbush v. Learned, 242 Mass. 297, 136 N. E. 341)

22. Under a sale agreement with the Apache Cotton Oil & Manufacturing Company, the Shaw-Spears Gin Company, of Wilburton, Oklahoma, shipped a quantity of cottonseed to Chickasha, Oklahoma. The bill of lading, made to the order of the shipper, with a draft drawn on the buyer, was sent to a bank. The buyer paid the draft, received the bill of lading, and found that the goods were defective. In an action brought by the buyer, the seller contended that title passed to the buyer upon delivery of the cottonseed to the carrier. Do you agree? (Shaw-Spears Gin Co. v. Apache Cotton Oil & Mfg. Co., 112 Okla. 202, 240 P. 732)

CHAPTER X

RELATION OF PARTNERSHIP

Part I—General Considerations

Introduction. Partnership is one of the most common forms of business association. This fact is due to the many advantages peculiar to this organization device. First, economy is effected by decreasing overhead costs of separate individual enterprises. Second, business may be increased by the accumulation of a greater amount of capital. Third, a combination is possible so as to unite personnel with different skill, knowledge, and experience. Fourth, by means of a partnership, division of labor may be obtained with close co-operation.

Partnership, one of the oldest forms of business association, has an origin which antedates the common law of England. This relation was highly developed by the Romans, and it was in common use during the Middle Ages. It was brought to England from European commercial cities in which such combinations were regulated by statutes. The law of partnership as it exists today is the result of common-law development in England, although it shows traces of continental influence. A Uniform Partnership Act, formulated by the National Commissioners on Uniform Laws for the purpose of bringing about uniformity in this branch of the law, is being adopted by state legislatures.

> The Uniform Partnership Act has been adopted in Alaska, Ark., Calif., Colo., Ida., Ill., Md., Mass., Mich., Minn., Nebr., Nev., N. J., N. Y., N. C., Oreg., Pa., S. D., Tenn., Utah, Vt., Va., Wash., Wis., and Wyo. (Uniform Laws Annotated, vol. 7, Cumulative Annual Pocket Part for use during 1947)

The relation of partnership, although possessing many advantages, carries with it certain important obligations. A person contemplating the use of this form of combination should be aware of the various obligations which the relation imposes, as well as the rights which accrue under it. The

problems arising in connection with partnership involve the creation of the relation, the powers and duties of the partners, the rights and liabilities of the partners, and the dissolution and termination of the relation.

Definition. *Partnership* is a legal relation created by a voluntary agreement between two or more persons for a combination of their capital, labor, or skill in a business or enterprise for joint profit. The Uniform Partnership Act states that "a partnership is an association of two or more persons to carry on as co-owners a business for profit." [1] The persons so associated are usually called *partners,* although they are sometimes called *copartners.* The relation or association is ordinarily identified as a partnership, but it is sometimes described as a *copartnership.*

> "A partnership is a status, and may exist by reason of the terms of an agreement, although the parties thereto incorporate therein a declaration to the contrary." (Martin v. Peyton, 219 App. Div. 297, 220 N. Y. S. 29)

Because of the difficulty in framing a satisfactory definition of partnership, some of its characteristic features are indicated. In general, they are:

First, a partnership is a relation contractual in nature and not imposed by law. As between the parties themselves, the relation is formed, governed, and terminated by the agreement. To be enforceable, an agreement to enter into a partnership requires all of the elements of a valid contract.

Second, a partnership is a voluntary relation between two or more persons. The personnel of a firm is entirely within the control of the parties. Because of the intimate and confidential nature of the relation, courts do not attempt to thrust a partner upon anyone.

Third, the relation of partnership usually involves contribution by the members, of capital, labor, or skill, or all of these. Some form of contribution is customary. Indeed, it is sometimes said that contribution is essential; but this is not always true, as there are instances in which memberships

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[1] §6—(1).

in partnerships have been given to persons who contributed nothing at all.

Fourth, the relation assumes or implies that the parties are associated as co-owners and principals to transact some lawful business or enterprise.

Fifth, a partnership is organized for the pecuniary profit of its members. In this respect the relation differs from almost all social organizations, such as clubs, societies, and committees.

Classification of Partnerships. Ordinary partnerships are classified as special, general, and universal partnerships, and also as trading and nontrading partnerships.

Special. This type of partnership is one formed for a single transaction. If two or more persons enter into a partnership for the purchase and resale of a certain building, there is a special partnership. This type is sometimes called a particular partnership.

General. A partnership of this form is one created for the general conduct of a particular kind of business or of several kinds of business. When two or more persons enter into a partnership to carry on a hardware business or a manufacturing business of some kind, the partnership is general.

Universal. This type of partnership is one in which the parties unite all their property and services and share in the joint profits. This is a very unusual relation and is rarely, if ever, established. One court, however, states that there is "no reason why parties should not be competent to form a universal partnership. There is nothing impracticable in it, nor against morality or public policy." [2]

Trading. Generally speaking, a trading partnership is one organized for the purpose of buying and selling, such as a firm engaged in the retail grocery business.

Nontrading. A nontrading partnership is one organized for noncommercial purposes. The relation may be entered into for the purpose of engaging in a profession, as when several attorneys or physicians join to practice law or medicine.

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[2] *Gray* v. *Palmer*, 9 Calif. 640.

It is very important that one keep in mind the type of firm with which he is dealing. The class into which a partnership falls determines to a large extent the powers of one member to bind the other members of the firm. It also in some measure governs the limitations on the powers of a partner that are required to be noticed by one dealing with such a partner.

Special Forms of Partnership. There are several peculiar forms of partnership. The two most important of these are joint-stock companies and limited partnerships.

Joint-Stock Companies. Joint-stock companies are of common-law origin, although in a number of states they are now regulated by statute. This form of partnership is mainly distinguished from the ordinary type by the transferability of the shares of its members. The contract of the members provides that any member may transfer his share, and that the person to whom the share is transferred shall be accepted as a partner. The management of the company is generally delegated to designated persons, because as a general rule the membership is much larger than that of an ordinary partnership. The business is usually, but not always, conducted under an impersonal name. The Adams Express Company is an illustration of a joint-stock company conducted under a personal name. With these exceptions, joint-stock companies are similar to ordinary partnerships and, in the absence of statutory regulation, are subject to the same rules.

> "It has been declared that a joint-stock company at common law lies midway between a corporation and a partnership, and partakes of the nature of both." (Hammond v. Otwell, 170 Ga. 832, 154 S. E. 357)

Limited Partnerships. This form of partnership is of statutory origin; it cannot be formed without enabling legislation. The purpose of this form of organization is to allow certain members to contribute capital without assuming liability beyond that amount. These members are described as *special partners.* The members who manage the business and assume full personal liability are termed *general partners.*

A majority of states have statutes permitting this form of organization, and a Uniform Limited Partnership Act has been proposed by the National Commissioners on Uniform Laws and recommended to the states for adoption. The statutes usually require the certificate to be executed, published, and recorded. This document must set forth the names of the partners, indicating whether they are general or special; their residence addresses; the name and the purpose of the organization; the amount of capital (usually required to be in cash) which is contributed by the special partners; and the period of time during which the association is to function.

> The Uniform Limited Partnership Act has been adopted in Alaska, Ariz., Calif., Colo., Fla., Hawaii, Ida., Ill., Iowa, Md., Mass., Mich., Minn., Nebr., Nev., N. H., N. J., N. Y., N. C., Pa., R. I., S. D., Tenn., Utah, Vt., Va., Wash., and Wis. (Uniform Laws Annotated, vol. 8, Cumulative Annual Pocket Part for use during 1947)

Courts usually require faithful compliance with the statute. The Uniform Limited Partnership Act states, however, that "a limited partnership is formed if there has been substantial compliance in good faith with the requirements." [3] A failure to comply with the general provisions renders the special partners liable to third persons as if they were general partners.

Firm Name. In the absence of a statutory requirement, it is not necessary that a partnership have a firm name, although it is customary to have one. The partners may, as a general rule, adopt any firm name desired. They may use a fictitious name, or even the name of a stranger. "The firm name is such as the copartners choose to adopt. It may disclose the names of all the partners or of none of them, or the name of but one of them may be used as the firm name." [4] Moreover, a firm may have several names, as one which has branch houses or conducts business at two places.

> "A partnership, in the absence of statute to the contrary, may adopt any name which it chooses, even though that name may suggest corporate existence." (Burke Mach. Co. v. Copenhagen, 138 Oreg. 314, 6 P. [2d] 886)

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[3] §2—(2).
[4] *Daugherty* v. *Heckard*, 189 Ill. 239, 59 N. E. 569.

There are, however, two limitations upon the partners' freedom in the adoption of a firm name. First, they cannot use a name when, in doing so, they would interfere with the prior rights of others to the name in question. Thus one firm cannot adopt the name of another firm for the purpose of attracting its patrons.[5] Second, they are restricted by statutes in some states as to the selection and use of a name. To illustrate, partners may be forbidden to use the term "and Company," as Jones, Smith and Company, unless the term "and Company" indicates an additional partner.[6]

Classification of Partners. Partners in ordinary partnerships may be classified as nominal, ostensible, silent, secret, and dormant partners.

Nominal. A nominal partner is one who holds himself out as a partner or permits others to hold him out as such.[7] He is not in fact a partner, as he neither shares in the management nor the profits; but he may in some instances be held liable as a partner. This will be pointed out later.

Ostensible. An ostensible partner is one who publicly and actively engages in the transaction of firm business. This is the usual type of partner.

Silent. A silent partner is one who may be known to the public as a partner, but who takes no active part in the conduct of the business.

Secret. A secret partner is one who takes an active part in the management of the firm, but who is not known to the public.

Dormant. A dormant partner is one who takes no active part in transacting the business and who remains unknown to the public.

Purposes of a Partnership. A partnership may be formed to carry on any lawful enterprise. Any business which a

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[5] *Robinson* v. *Storm*, 103 Tenn. 40, 52 S. W. 880.
[6] *Gay* v. *Seibold*, 97 N. Y. 472.
[7] This type of partner is sometimes called an ostensible partner, a holding-out partner, or a quasi partner.

person individually may lawfully transact may be conducted in partnership form. The relation may be created for the purpose of manufacturing, lumbering, transportation, mining, farming, commerce, or professional occupations. Thus two or more persons may enter into a partnership for the purpose of buying and selling oil wells.[8] Also, if two or more dentists wish to form a union to carry on their occupation, they may enter into a partnership contract for this purpose.

> "There can be a partnership for a single transaction." (Real Estate-Land Title & Trust Co. v. Stout, 117 N. J. Eq. 37, 175 A. 128)

There are, however, many purposes for which parties may not unite in partnership. The relation cannot be created to carry out immoral or illegal acts. To illustrate, two persons cannot lawfully enter into a contract of partnership to manufacture and sell liquors contrary to statutes prohibiting such business.[9] Also, an agreement to form a partnership to carry on business with enemy aliens is illegal, because its purpose is contrary to public policy.[10]

> A partnership between a resident and a nonresident of a state for the purpose of fishing operations, created to avoid a statute prohibiting licenses to nonresidents, is illegal. (Smith v. P. J. McGowan & Sons, 131 Oreg. 522, 284 P. 189)

The effect of illegality of the purpose is a denial to the members of a right to sue on contracts involving the illegality. Moreover, the members cannot seek the aid of courts to settle their affairs among themselves. Thus courts ordinarily will not entertain a suit to compel a member who has under his control funds of an unlawful transaction, to divide the proceeds with his associates.[11]

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[8] *Bird* v. *Wilcox*, 104 Kans. 799, 180 P. 774.
[9] *McMullen* v. *Hoffman*, 174 U. S. 639, 43 L. Ed. 1117.
[10] *Jackson* v. *Akron Brick Ass'n*, 53 Ohio St. 303, 41 N. E. 257.
[11] *Hunter* v. *Pfeiffer*, 108 Ind. 197, 9 N. E. 124.

QUESTIONS

1. "Partnership, because of the many advantages peculiar to it as an organization device, is one of the most common forms of business associations." Do you agree with this statement?

2. Several men form an association called the Friendly Hand Society. Each member contributes five hundred dollars annually to the organization. The purpose of the association is to render assistance to boys placed on parole by the juvenile court. A creditor contends that this association is a partnership. Is his contention sound?

3. Brawley, Wells, and Reeder enter into a partnership for the purpose of manufacturing and selling toilet articles. Classify this organization as a special, general, or universal partnership.

4. Goodman and Horlick are discussing joint-stock companies. The former contends that this form of partnership differs mainly from an ordinary partnership in that the management of the company is delegated to designated persons. Do you agree?

5. Frankel, Zeigler, and Walling organize a limited partnership under a statute which requires that the contribution of the special partner shall be in cash. Walling, the special partner, contributes other property in lieu of money. A creditor seeks to hold Walling liable as a general partner. Is he entitled to do so?

6. Cordick and Finnegan form a partnership for the purpose of making and selling jewelry. They adopt as their firm name, The Acme Jewelry Company. Is this a valid name for the firm?

7. Kruth and Meeks also form a partnership for the purpose of making and selling jewelry, and adopt the same name as given in the foregoing case. When Cordick and Finnegan complain of the use of this name by Kruth and Meeks, the latter contend that a partnership can, in the absence of statute, use any name desired. Is this contention sound?

8. A partnership is conducting a clothing store under the name of the Keeler, King and Knight Company. Keeler actively conducts the business. King is a banker and, although known to be a partner in the firm, takes no active part in the business. Knight is merely lending his name to the organization. Kruth, the fourth partner, is not known to the public and takes no active part in the transacting of the business. Classify Keeler, King, Knight, and Kruth as partners.

9. Dundon and Gordon are contemplating forming a partnership for the practice of dentistry. The former questions the validity of a partnership for this purpose. The latter declares that a partnership may be formed for any purpose. Do you agree?

10. Carlson and Ryan form a partnership for the purpose of engaging in fraudulent land sales. After several transactions Carlson refuses to make an accounting as to the profits. Ryan thereupon brings a suit to compel Carlson to divide the proceeds. Is he entitled to recover?

Part II—Creation of Partnership

Actual Partnerships. Any number of persons who are competent to contract may, in the absence of statutory provisions to the contrary, enter into a partnership. As has been indicated previously, certain persons labor under a legal or natural incapacity. To illustrate, an infant, although he may be a partner, may elect to avoid his contract of partnership.[1] In general, the capacity of an insane person to be a partner is similar to that of an infant, except that an adjudication of insanity usually makes subsequent agreements void rather than merely voidable. An enemy alien may not be a partner, but other aliens may enter into the relation. Under modern statutes a married woman may in most states enter into partnership, although ordinarily at common law she could not. In some states, however, she is still incapacitated to join with her husband as a partner, either on the ground of public policy or because of the wording of a statute.[2] A corporation, unless expressly authorized, may not act as a partner.

> A partnership and an individual may enter into a partnership for the purpose of engaging in the business of drilling contractors. (Houston v. McCrory, 140 Okla. 21, 282 P. 149)

A true partnership rests upon the intention of the parties concerned. It may be created either by express agreement or by implied agreement.

Express Agreement. If the relation of partnership arises out of express agreement, there is very little difficulty in determining whether one exists, as the express intention of the parties ordinarily governs the situation. This, however, is not always true. Thus, even though the parties intend a partnership and call themselves partners, the relation does not result if in their agreement they create no community of interest in the business or profits.[3] One court stated that it did not "attach much importance to the declaration of ignorant men" for the reason that "the real test is the legal effect

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[1] *Ante*, p. 119.
[2] *Barlow* v. *Parsons*, 73 Conn. 696, 49 A. 205.
[3] *Sailors* v. *Nixon-Jones*, 20 Ill. A. 509.

of their agreement and not what they may in their ignorance imagine its legal effect to be." [4]

Implied Agreement. A partnership may be implied by acts, words, and conduct of the parties even though the parties do not in fact intend to form a partnership. To illustrate, two parties may wish to be associated in some venture, but not as partners. If the terms of their agreement provide for the necessary incidents of partnership, the relation will result in the absence of express stipulations or circumstances to the contrary.[5] That a partnership exists against the intentions of the parties is important in two instances: first, when one or more members of an association contend that such a relation exists, and the others deny it; second, when creditors seek to hold the members of the association liable as partners.

Articles of Partnership. Partnership agreements, generally speaking, need not be in writing. In some instances, however, they must be. A partnership agreement must be in writing if it is within the provision of the Statute of Frauds that a contract which is not to be performed within the space of one year must be in writing. Thus an agreement to create a partnership two years hence, or to create a present partnership which is to continue for more than one year, must be evidenced in writing.[6] Courts in some states hold that under another provision of the same statute partnerships formed to deal in land must also be in writing. Most states, however, rightly adopt the contrary rule, as the agreement does not properly come within the provisions of the Statute of Frauds. In some situations, however, the agreement may come under the provision of the statute, which requires a transfer of interest in land to be in writing. For example, if by the terms of the partnership agreement one partner is to gain an interest in real property already owned by the other, the agreement must be in writing.[7]

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[4] *Whetstone* v. *Purdue*, 107 Oreg. 86, 213 P. 1014.
[5] *Wade* v. *Hornsday*, 92 Kans. 293, 140 P. 870.
[6] *Sanger* v. *French*, 157 N. Y. 213, 51 N. E. 979.
[7] *Miller* v. *Miller*, 156 Ky. 267, 160 S. W. 923.

Although generally unnecessary, it is always desirable to have the partnership agreement in writing to avoid subsequent controversies as to mutual rights and duties. The formal doc-

ARTICLES OF COPARTNERSHIP

This Contract, *Made and entered into on the* second *day of* July *19*
by and between E. C. Cline of Little Rock, Ark., party of the first part,
and J. G. Pipkin of the same city and state, party of the second part.

WITNESSETH: That the said parties have this day formed a copartnership for the purpose of engaging in and conducting a retail wood, coal and ice *business under the following stipulations which are made a part of this contract:*

FIRST: The said copartnership is to continue for a term of three years *from date hereof.*

SECOND: The business shall be conducted under the firm name of Cline & Pipkin *at* 212 South Main Street, Little Rock, Ark.

THIRD: The investments are as follows: Each partner invests $2,000.00 cash.

FOURTH: All profits or losses arising from said business are to be shared as follows: Equally

FIFTH: A systematic record of all transactions is to be kept in a double entry set of books, which are to be open for the inspection of each partner. On June 30 and December 31 *hereafter a statement of the business is to be made, the books closed and each partner credited with the amount of the gain. A statement may be made at such other time as the partners agree upon.*

SIXTH: Each partner is to devote his entire time and attention to the business and to engage in no other business enterprise without the written consent of the other.

SEVENTH: Each partner is to have a salary of $ 100.00 *per month, the same to be withdrawn at such time or times as he may elect. Neither partner is to withdraw from the business an amount in excess of his salary without the written consent of the other.*

EIGHTH: The duties of each partner are defined as follows: E. C. Cline is to have general supervision of the business, and have charge of credit and collections, all correspondence, and the accounting records. J. G. Pipkin is to have supervision of incoming and outgoing merchandise, and the merchandise stock. Each partner is to attend to such other duties as are deemed necessary for the successful operation of the business.

NINTH: Neither partner is to become surety or bondsman for anyone without the written consent of the other.

TENTH: In case of the death, incapacity, or withdrawal of either partner, the business is to be conducted for the remainder of the fiscal year by the surviving partner, the profits for the year allocated to the withdrawing partner to be determined by the ratio of the time he was a partner during the year to the whole year.

ELEVENTH: In case of dissolution, the assets are to be divided in the ratio of the capital invested at the time of dissolution.

IN WITNESS WHEREOF, The parties aforesaid have hereunto set their hands and affixed their seals on the day and year above written.

E. C. Cline
J. G. Pipkin

ARTICLES OF COPARTNERSHIP

ument which is prepared to evidence the contract of parties is termed *articles of partnership.*

Partnership articles do not purport to provide for every possible contingency, and they vary, of course, in accordance with the requirements of the particular situation. Generally, however, they should contain provisions relating to the following: (1) date; (2) names of the partners; (3) recital of agreement to be partners; (4) nature of the enterprise; (5) duration of the relation; (6) name of the firm and location; (7) contributions to capital; (8) manner of sharing profits and losses; (9) withdrawals of money; (10) keeping of accounts; (11) duties of partners; (12) unusual restraints upon partners; and (13) final distribution of assets.

Determining the Intention of the Parties. If there is an agreement providing for all of the characteristic features of a partnership, the question of intent is then, of course, easily solved. Unfortunately, however, there are many situations in which courts have to employ several tests as aids in discovering the intention of the parties. A few of these tests are as follows.

Sharing Profits and Losses. The fact that the parties share profits and losses is strong evidence of a partnership. Combined with other factors, it is conclusive. To illustrate, when the parties, besides having an agreement to share profits and losses, have a joint interest in the property, the relation is usually held to be a partnership.[8]

> "The mere participation in profits and losses does not necessarily create a partnership between the parties so participating." (Furlong v. White [Mo. A.], 2 S. W. [2d] 162)

Sharing Profits. An agreement which does not provide for sharing losses but does provide for sharing profits is evidence that the parties are united in partnership, as it is assumed that they will also share losses. A person may, however, share in the profits only and not be a partner. Thus, if a person agrees to work as an agent for another and to accept

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[8] *Berthold* v. *Goldsmith,* 24 How. (U. S.) 541, 16 L. Ed. 762.

as compensation one fourth of the profits, the agreement does not necessarily make him a partner.[9]

> "It is well settled that the mere sharing of profits is not a conclusive test of a partnership." (First Nat. Bank v. Williams, 142 Oreg. 648, 20 P. [2d] 222)

The Uniform Partnership Act provides that sharing profits is prima facie evidence of a partnership, but that a partnership is not to be inferred when profits are received in payment (1) of a debt, (2) of wages, (3) of rent, (4) of an annuity to a deceased partner's widow or representative, (5) of interest, or (6) for the good will of the business.[10]

> A contract whereby two men were appointed as managers of a ranch, and were to receive a share of profits from the sale of the increase of stock, was held to be a contract of employment, not a partnership. (Hill Cattle Corporation v. Killom, 79 Mont. 327, 256 P. 497)

Gross Returns. The sharing of gross returns is of itself very slight, if any, evidence of partnership. When the parties contribute property for a given enterprise but retain title to it, no partnership results although they agree to share the gross returns. To illustrate, in a case in which one party owned a show which was exhibited upon land owned by another under an agreement to divide the proceeds, no partnership was proved, as there was no community of interest in the business.[11]

Partners as to Third Persons. We have been considering true partnerships created, expressly or impliedly, by the words or conduct of the parties. Parties to such relations are partners as to one another, as well as to third persons. One may, however, become liable as a partner when he is not so in fact. This liability occurs when a person conducts himself in such a manner that third persons are reasonably led to believe that he is a partner and to act in reliance thereon to their injury. One is not permitted to deny representations expressly or impliedly made which reasonably lead another to act to his

[9] *Sodiker* v. *Applegate*, 24 W. Va. 411.
[10] §7—(4).
[11] *McDonough* v. *Bullock*, 2 Pears. (Pa.) 191.

detriment. The person who incurs such liability is termed a *nominal partner* or a *partner by estoppel.*

> "In the absence of estoppel a party cannot be held liable as a partner with another where a partnership did not in fact exist between them." (Henry G. Taussig Co. v. Poindexter, 224 Mo. A. 580, 30 S. W. [2d] 635)

The liability of one as a partner, when he is not in fact a partner, depends upon two conditions which must be shown.[12] First, it must be shown that the party represented himself or permitted others to represent him as a partner. Thus, if one falsely states that he is a member of a partnership, and the person to whom the statement is made extends credit to the firm, the latter is entitled to hold him liable as a partner.[13] The same rule is applied if one person tells another that a third person is his partner, and the third person being present and hearing the statement does not deny the relation.[14] Second, it must be shown that the party seeking to hold another as a partner has in good faith reasonably relied upon, and been not only misled, but also injured, by the latter's representation. To illustrate, assume that White permits a member of a firm to hold him out as a partner to Green. Brown, without knowledge of the representation, extends credit to the partnership and seeks to hold White liable as a partner. He cannot do so, because White is liable only to the one who knew of the representation.[15] So, also, if Green had extended credit to the firm, but with the knowledge that White was not a partner, he could not have held the latter liable, for he either would not have relied upon the representation or would not have acted in good faith.[16]

Firm Property. There is usually no limitation upon the kind of property which a partnership may acquire. The firm may possess real as well as personal property, unless it is prohibited from doing so by statute or by the articles of partnership. Likewise, unless there are restrictions imposed

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[12] *Uniform Partnership Act*, §16—1.
[13] *Fletcher* v. *Pullen*, 70 Md. 205, 16 A. 887.
[14] *Thompson* v. *First Nat'l Bank*, 111 U. S. 529, 28 L. Ed. 507.
[15] *Wood* v. *Pennell*, 51 Me. 52.
[16] *Morgan* v. *Farrel*, 58 Conn. 413, 20 A. 614.

by statute or by the articles of partnership, the amount of property which the firm may acquire is not limited.

It is sometimes difficult to determine what constitutes partnership property. The firm may have only the use of certain property. To illustrate, two persons purchase property in their own names and with their own funds. Later they become partners and use this property in the firm business. This use of the property alone does not make it firm property.[17] On the other hand, the title to firm property may be held by one or more members of the firm, as noted in the following section.

> Holding that a seat on the stock exchange used by a firm was the property of one partner, the court said: "Whether property owned by a partner and used in the firm business shall be deemed an asset of the firm or of the individual depends upon the intention of the partners." (In re Amy, 21 F. [2d] 301)

In general, partnership property consists of all the property originally contributed by the partners or later acquired for the firm or with its funds. The Uniform Partnership Act provides that: "first, all property originally brought into the partnership stock or subsequently acquired by purchase or otherwise, on account of the partnership, is partnership property; second, unless the contrary intention appears, property acquired with partnership funds is partnership property." [18] The fact that a member of a firm buys property with firm money is strong evidence that that property is firm property. It is not conclusive, however, as this procedure may have been arranged with the other partners with the intention that the property should belong to the member who did the purchasing. The firm may, in other words, advance money to a member, with which he may buy property as his own.

Title to Partnership Property. A partnership may acquire and dispose of the title to personal property in the firm name, whether the name is artificial or personal. Thus a partnership may hold a mortgage on personal property in the firm

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[17] *Robinson Bank* v. *Miller*, 153 Ill. 244, 38 N. E. 1078.
[18] §8.

name.[19] It is not necessary, however, that personal property be held in the firm name. One or more members may take title to the personalty of the partnership. This may occur either through the agreement of all the members or through the violation by one of some duty to the others. In both instances the property is regarded as belonging to the firm, and courts will protect the rights of the other partners in the property.

> "A partnership, as such, can at law be the vendee in a bill of sale or other conveyance of personal property." (Hendren v. Wing, 60 Ark. 561, 31 S. W. 149)

Title to real property at common law cannot be held in the firm name on the theory that such title must vest in either a natural or an artificial person. To illustrate, a deed to "Todd, Gorton and Company" would not convey legal title at common law.[20] The rule was particularly adhered to when the firm name was wholly fictitious. Many courts, however, to save the conveyance, held that the legal title would vest in the partners whose names appeared in the firm name. Thus, if a deed was made out to "George F. Lovejoy and Company," the legal title would pass to Lovejoy.[21] There has been a tendency on the part of courts to hold conveyances to a partnership in the firm name valid, even when the name does not contain a personal name. This view has been adopted by the Uniform Partnership Act which states: "Any estates in real property may be acquired in the partnership name. Title so acquired can be conveyed only in the partnership name." [22]

Partner's Interest in Firm Property. Partnership property is held in a peculiar form of tenure called *tenancy in partnership.* The Uniform Partnership Act states that "a partner is co-owner with his partners of specific property, holding as a tenant in partnership." [23] Many courts have confused this distinct form of tenure with joint tenancies and tenancies in common. Although there are some characteristics in common, the tenancies are in fact different. The ordinary joint tenant

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[19] *Kellogg* v. *Olsen,* 34 Minn. 304, 24 N. W. 364.
[20] *Todd* v. *Rines,* 140 Mass. 31, 2 N. E. 687.
[21] *Perciful* v. *Platt,* 36 Ark. 456.
[22] §8—4; see also §8—5.
[23] §25—1.

has full beneficial ownership upon the death of the co-tenant, whereas a surviving partner does not. A tenant in common may alienate his interest, putting another in his place, but a partner cannot do so.

The incidents of a tenancy in partnership are:

(1) All partners in the absence of contrary agreement have equal right to use firm property for partnership purposes. They may not use such property for their own use without the consent of the others.

(2) A partner possesses no interest in any specific portion of the partnership property which he can sell, assign, or mortgage. To illustrate, if two partners possess an automobile as firm property, and one of them sells his interest in the car to a third person, the sale has no effect. The partner has no right in the specific property which he can alienate.[24]

(3) A few states permit the creditors of a partner to levy on and sell his interest in specific partnership property. This rule is not adopted in most states and is expressly denied under the Uniform Partnership Act.[25]

(4) The interest of each partner in specific firm property vests in the surviving partners, but only for partnership purposes.

(5) A partner's interest in specific property is not subject to dower or curtesy.

QUESTIONS

1. Rawson and Wakefield form a partnership to deal in land for a period of nine months. Six months later Wakefield withdraws from the firm. Rawson brings an action for damages arising out of breach of contract. Wakefield's defense is that the agreement is not in writing. Is this a valid defense?

2. Merick enters into a partnership with Wagner for the purpose of operating a garage. Some years later it is discovered that Wagner is an alien. Merick contends that this fact incapacitated Wagner from entering into partnership. Is his contention sound?

3. "The relation of partnership arises only out of an express agreement." Do you agree with this statement?

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[24] *Sloan* v. *Wilson*, 117 Ala. 583, 23 S. 145.
[25] §25—2 (c).

4. On February 17, Gerson orally agrees to form a partnership with Teske one year from the following May. When the time arrives, Gerson refuses to perform his promise. Teske brings an action for breach of contract. Is Gerson liable for damages?

5. It is stated that the articles of partnership consist of an agreement which outlines all of the rights and obligations of the partners. Do you agree?

6. Heuser sells his business to Rourke and Jesselson. The terms of the deal provide for a payment of ten thousand dollars in cash for the property, and annual payments of ten per cent of the profits for the good will of the business. A creditor later brings an action against Heuser, Rourke, and Jesselson as partners. Is he entitled to judgment against Heuser?

7. Sanger refuses an invitation to become a partner of Peterson and Sheafe in the retail grocery business. Nevertheless, Peterson and Sheafe insert an advertisement in the newspaper representing Sanger as their partner. Sanger takes no steps to deny the existence of such a partnership. Coleman, who extended credit to the firm, seeks to hold Sanger liable as a partner. Can he do so?

8. Honan, Jenson, and Keith form a partnership for the purpose of engaging in the retail coal business. Honan purchases a filing cabinet with funds belonging to the firm. This amount is considered by all of the partners as an advance payment of part of Honan's share in the profits. A judgment creditor of the firm who levies on the filing cabinet alleges that it is firm property. Do you agree?

9. Hermanek and Bovik enter into a partnership under the name of Hermanek and Company. The firm purchases a farm for the purpose of their business. The owner of the land in conveying the property makes out the deed to Hermanek and Company. Is this a valid deed?

10. A partnership insures all of the firm property. One of the partners sells to Forman his interest in a truck belonging to the firm. Subsequently a fire destroys part of the property including the truck. The insurance company refuses to indemnify the firm on the ground that a condition of the policy prohibited any change in ownership. The firm brings an action to recover on the policy. Is it entitled to judgment?

Part III—Duties, Rights, and Authority of Partners

Duties of Partners. The nature of the partnership necessarily requires that each partner shall to a very great extent trust his copartners. It has been stated that "there is no stronger fiduciary relation known to the law than that of a copartnership, where one man's property and property rights are subject to a large extent to the control and administration of another." [1] For this reason the law prescribes certain standards of conduct to which members of a firm must adhere. Some of the obligations which are imposed upon a partner in relation to his copartner are:

Good Faith. A partner must in every instance act with strict fidelity to the interests of the firm. He must use his powers and the firm's property for the benefit of the partners, and not for personal gain. His duties to the firm must be observed prior to the furtherance of his own interests. To illustrate, when one partner in his own name renewed a lease on the premises occupied by the firm, he was compelled to hold the lease for the firm on the ground that his conduct was contrary to the good faith required of partners.[2]

> Partners, engaged in business of tax consultants, "owed each other highest of good faith," hence could not conceal the fact that they had dealings with certain clients. (Shelly v. Smith, 271 Mass. 106, 170 N. E. 826)

Skill and Care. A partner must use reasonable care in the transaction of the business of the firm. He is liable for any loss resulting from his failure to do so. He is not liable, however, for honest mistakes or errors of judgment. Nor is he liable when the complaining partner likewise failed in his duty to do or not to do the same act. Thus, when one partner failed to use reasonable care in collecting the debts owed to the firm, the other partner was not justified in complaining, as he was equally at fault in not making the collections, unless the former, as managing partner, had general control of affairs.[3]

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[1] *Salhinger* v. *Salhinger*, 56 Wash. 134, 105 P. 236.
[2] *Mitchell* v. *Reed*, 61 N. Y. 123.
[3] *Lyons* v. *Lyons*, 207 Pa. 7, 56 A. 54.

Attention to Firm Business. In the absence of agreement to the contrary, a partner is required to give his undivided time and energy to the development of the business of the partnership. Even when a partner is not required to give all his time to the firm's business, he has no right to devote his time and labors to the promotion of a competing business. If he does, he is liable for damages to his partners. To illustrate, two persons form a partnership for the purpose of making and selling hats, and one of them, unknown to the other, engages in an individual enterprise of the same nature. The latter, not having given his assent, may compel the former to account for the profits of the competing business.[4]

> A partner "cannot carry on another business in competition or rivalry with that of the firm." (Johnson v. Ironside, 249 Mich. 35, 227 N. W. 732)

Keeping Accounts. A partner must make and keep, or turn over to the proper person, correct records of all business which he has transacted for the firm. When the partners are equally at fault in not making and keeping proper records, however, neither can complain. Thus, if a firm employs the services of a bookkeeper who commits serious errors, one partner cannot complain unless the other was in some way responsible for the errors.[5]

> Although a partner must account for all his acts, "when the partnership was formed, the parties could by agreement determine the manner in which such accounting should be had." (Carr v. Hoffman, 256 N. Y. 254, 176 N. E. 383)

Keeping Agreement. Each partner is under an obligation to do all that is required of him by the partnership agreement. Duties and restrictions are frequently imposed upon certain members by the articles of partnership. These must be observed. To illustrate, if a partnership is formed with the understanding that one of the partners shall take no part in transacting the business, and a loss is suffered because of a violation of the agreement, this partner must indemnify the other.[6]

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[4] *Wiggins* v. *Markham*, 131 Iowa 102, 108 N. W. 113.
[5] *Folson* v. *Marlette*, 23 Nev. 459, 49 P. 39.
[6] *Haller* v. *Willamowica*, 23 Ark. 566.

Rights of the Partners. The law, while imposing certain duties upon the members of a firm, also recognizes certain rights of each member. Of these the most important are here considered.

Management. Each partner, in the absence of a contrary agreement, has a right to take an equal part in transacting the business of the firm. To illustrate, three persons enter into a partnership. The first contributes $5,000 in cash; the second, property valued at $3,000; and the third, his skill and labor. All possess equal rights to participate in the conduct of partnership business.[7] This rule is adopted by the Uniform Partnership Act which states that "all partners have equal rights in the management and conduct of the partnership business." [8] The act further provides that "partners shall render on demand true and full information of all things affecting the partnership to any partner or the legal representative of any deceased partner or partner under legal disability." [9]

> When there are more than two partners, "in case there is a disagreement as to such management, the majority governs." (Anderson v. Whitmer, 127 Okla. 284, 261 P. 156)

Contribution. A partner who has paid more than his share of the debts or liabilities of the firm, which should justly fall upon all the members, has a right to demand proportionate contributions from his copartners. Thus, if an employee of a firm negligently injures a third person while acting within the scope of his employment, and the injured party collects damages from one partner, the latter may enforce contributions from the copartners.[10] The partner has no right, however, to indemnity or reimbursement when he, first, acts in bad faith; second, negligently causes the necessity for payment; or, third, has previously agreed to bear the expense alone. The Uniform Partnership Act states that "the partnership must indemnify every partner in respect to payments made, and personal liabilities reasonably incurred by him, in

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[7] *Katz* v. *Brewington*, 71 Md. 79, 20 A. 139.
[8] §18—(e).
[9] §20.
[10] *Spery* v. *Tulley*, 76 W. Va. 106, 84 S. E. 1067.

the ordinary and proper conduct of its business, or for the preservation of its business or property." [11]

> One partner paying $1,700 attorney's foreclosure fees in connection with the firm business, was entitled to recover one half the sum paid from his partner. (Vandivier v. Daviess, 245 Ky. 677, 54 S. W. [2d] 32)

Return of Advances. A partner is entitled to have returned to him any amounts of money advanced to or for the firm. These amounts must, however, be separate and distinct from original or additional contributions to the capital of the firm, and must also be properly made. Thus, if one partner makes advances for the firm, contrary to the articles of partnership, he cannot hold his copartners liable unless they gave their consent.[12]

In the absence of agreement to the contrary, advances constituting contributions to capital do not draw interest on the theory that the profits constitute sufficient compensation. The Uniform Partnership Act states that "a partner shall receive interest on the capital contributed by him only from the date when repayment should be made." [13] The partners may, of course, agree to pay interest on the capital contributions.

In earlier decisions courts were reluctant to allow interest on other advances until after an accounting was made, unless interest was provided for by agreement. Courts are now inclined to treat advances in the form of loans as if they were made by a stranger. The Uniform Partnership Act adopts this view, providing that "a partner who, in aid of the partnership, makes any payment or advance beyond the amount of capital which he agrees to contribute, shall be paid interest from the date of payment or advance." [14]

> When an advance for the use of the firm is in fact a loan, "then the partner is entitled to interest upon such advance unless there is an understanding or usage or other circumstances tending to show the contrary." (Williamson v. Frank, 222 Mo. A. 643, 5 S. W. [2d] 462)

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[11] §18—(b).
[12] *McFadden* v. *Leeka*, 48 Ohio St. 513, 28 N. E. 874.
[13] §18—(d).
[14] §18—(c).

Compensation. Although one partner performs more duties or renders more valuable services than the other partner, he is not entitled to compensation for these services in the absence of an agreement to that effect. To illustrate, when one partner becomes seriously ill and the others transact all of the firm's business, the latter are not entitled to compensation, as the sickness of a partner is considered a risk assumed by the relation.[15] In a large number of states it has been held that a partner is not entitled to extra compensation even for work done as a surviving partner. On this point the opposite view is taken by the Uniform Partnership Act, which states that "no partner is entitled to remuneration for acting in the partnership business, except that a surviving partner is entitled to reasonable compensation for his services in winding up the partnership affairs." [16]

Inspection of Books. In the absence of an agreement to the contrary, all partners are equally entitled to inspect the books of the firm. The Uniform Partnership Act provides that "the partnership books shall be kept, subject to any agreement between the partners, at the principal place of business of the partnership, and every partner shall at all times have access to and may inspect and copy any of them." [17]

Remedies of Partners. The remedies available to the members of a firm are in some instances limited because of the peculiar relation of the partners and because of the nature of their claims. It should be borne in mind that partners are usually regarded as individuals, although occasionally they are for some purposes regarded as an entity.

Actions at Law. A partner cannot maintain an action at law against the firm upon a claim against the partnership. There are two reasons assigned for this rule. First, if such an action were allowed, the plaintiff being a member of the firm would also be a defendant, which is not permissible under common-law procedure. Second, the nature of the claim

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[15] *Heath* v. *Waters*, 40 Mich. 457.
[16] §18—(f).
[17] §19.

is such that there must be an accounting by the firm in order to determine whether anything is due the complaining partner. Common-law courts did not furnish adequate means to determine this question.

A partnership cannot, for the first reason stated above, bring an action at common law against one of its members on claims which the firm holds against him. In the absence of statute a partnership cannot maintain an action against another firm when they have partners in common. Thus, if a firm, composed of Hagen, Greer, and Carey, has a claim against a partnership whose membership consists of Filby, Rice, and Carey, the creditor firm cannot bring an action at law against the other, because one of the members would appear as both plaintiff and defendant.[18]

> "Because a man cannot sue himself, a firm which has a partner common to an adversary firm cannot maintain an action at law against that firm." (Newport Const. Co. v. Porter, 118 Oreg. 127, 246 P. 211)

One partner cannot maintain an action at common law against the other on claims involving partnership transactions. To illustrate, if one partner claims that his partner owes him a sum of money advanced for the firm, he cannot recover in an action at common law, as an accounting is necessary to determine the matter.[19] Here again only one of the reasons set forth above applies, but in this instance the question of parties is not involved. There are two exceptions to the general rule that one partner cannot sue another at common law on claims involving firm transactions: first, when the claim has been distinguished from firm dealing by agreement; and, second, when the firm accounts have been balanced and show the amount to be due.

> "The mere fact that a dissolution of the partnership has taken place before the action is brought does not change the rule that no action at law can be maintained between partners." (Johnstone v. Morris, 210 Calif. 580, 592 P. 970)

Partners may sue each other at common law in cases in which there is no necessity of investigating the partnership

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[18] *Crosby* v. *Timolat*, 50 Minn. 171, 52 N. W. 526.
[19] *Spear* v. *Newell*, 13 Vt. 288.

accounts. This is true, although the cause of action is in some way connected with the firm. Situations of this kind exist when a partner dissolves the relation in violation of his agreement, when a partner fails to furnish capital or services agreed, or when a partner wrongfully causes injuries to his copartner, which in no way involve the partnership.[20]

Actions in Equity. The proper tribunal to settle all controversies growing out of partnership transactions is a court of equity. The powers of this court are such as to enable it to settle fully problems which arise in winding up the affairs of the firm.

Upon a showing of cause, an injunction may be granted at the request of one partner against the other for proper cause. It may be granted to prevent injuries by acts before, pending, or after dissolution. Thus one may enjoin a former partner from giving the impression that the firm still exists.[21] On the other hand, a court of equity will in some instances compel performance of an act by one partner. To illustrate, the court will enforce an agreement that the books of the firm are to be kept at a certain place.[22]

> "The drastic remedy of receivership among partners ought to be avoided whenever possible." (Oberto v. Moore, 93 Colo. 93, 23 P. [2d] 578)

In most instances the aid of the court is sought in connection with an accounting and a dissolution of the firm. It was at one time held that an accounting must be accompanied by a dissolution, but this view was later modified so as to permit a separate accounting. The Uniform Partnership Act states that a partner is entitled to an accounting, first, if he is wrongfully excluded from the partnership business or possession of its property by his copartners; second, if the right exists under the terms of any agreement; third, if he is a trustee; or, fourth, if other circumstances render an accounting just and reasonable.[23]

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[20] *Newson* v. *Pitman*, 98 Ala. 526, 12 S. 412.
[21] *Fletcher* v. *Vendusen*, 52 Iowa 448, 3 N. W. 488.
[22] *Lingen* v. *Simpson*, 1 Simons & Stuart, 600.
[23] §22.

Authority as Between Partners. In the absence of agreement as to the authority of the partners, it is assumed that each possesses the usual powers of partners in similar firms. The partners may, of course, agree as to the extent of each member's authority. This agreement is binding as between themselves, but it does not bind third persons unless notice of the agreement is brought to their attention. Thus, when a partner, contrary to an agreement with his partners, makes certain purchases for the firm from a third person, the firm is bound if the third person was unaware of the agreement.[24] In such a case, however, the partner violating the agreement is liable to his partners for any loss caused by the breach of contract. If the third person had known of the limitation, the firm would not be bound. The Uniform Partnership Act expressly states that "no act of a partner in contravention of a restriction on his authority shall bind the partnership to persons having knowledge of the restriction.[25]

> When limitations on authority are secret, third persons may proceed "on the presumption that any act within the general scope of a partner, as agent of the firm, is within the authority of the partner with whom he deals." (Simons v. Northern Pac. Ry. Co., 94 Mont. 355, 22 P. [2d] 609)

When there are more than two members of the firm, the decision of the majority prevails on matters involving the manner in which the ordinary functions of the business will be conducted. To illustrate, the majority of the members of a firm decide to increase their advertising and enter into a contract to that end. The minority, having protested at the time of the action, now disclaim any responsibility on the contract. The transaction is valid and binds all of the partners.[26] The act of the majority is not binding if it contravenes their original agreement. Thus the majority of the members cannot change the nature of the business against the protests of the minority.[27] The Uniform Partnership Act states that "any difference arising as to the ordinary matters connected

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[24] *Moore* v. *May*, 117 Wis. 192, 94 N. W. 45.
[25] §9—4.
[26] *Williams* v. *Kemper H. & M. Dry Goods Co.*, 4 Okla. 145, 43 P. 1148.
[27] *Abbott* v. *Johnson*, 32 N. H. 9.

with the partnership business may be decided by a majority of the partners; but no act in contravention of any agreement between the partners may be done rightfully without the consent of all the partners." [28]

Authority as to Third Persons. As between the firm and third persons, each partner, generally speaking, has authority as an agent to bind the other members in transactions within the customary scope of the business. Thus, if two persons form a partnership for the purpose of buying and selling used vehicles, the firm is bound when either of the partners makes a contract for the purchase of this kind of property.[29] The partners may, by express or implied consent, enlarge or decrease the normal powers of a member.

> In the case of one firm, the articles of partnership prohibited any partner borrowing money for any purpose "unless the same shall be secured by recognized stock exchange collateral." (Back Bay Nat. Bank v. Brickley, 254 Mass. 261, 150 N. E. 11)

Third persons dealing with a partner are required to act reasonably and in good faith. The Uniform Partnership Act provides that "every partner is an agent of the partnership for the purpose of its business, and the act of every partner, including the execution in the partnership name of any instrument, for apparently carrying on in the usual way the business of the partnership of which he is a member binds the partnership, unless the partner so acting has in fact no authority to act for the partnership in the particular matter, and the person with whom he is dealing has knowledge of the fact that he has no such authority." [30]

> Restrictions on the authority of a partner to sell the business, though known to the third person, may be waived by the other partners. (Cowan v. Tremble, 111 Calif. A. 458, 296 P. 91)

A third person cannot, of course, assume that a partner has all the powers he claims. There are certain things of which he must take notice.

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[28] §18—(h).
[29] *Pohlman* v. *Taylor*, 75 Ill. 629.
[30] §9—1.

(1) A third person must act in accordance with known limitations on the authority of a partner. Thus, when a third person is negotiating with one of two partners for the purchase of goods within the general scope of the firm's business, and the other partner notifies him that he opposes the transaction, the third person can hold only the one partner if he completes the transaction.[31]

(2) A third person must take notice of an act of a partner that is obviously against the interest of the firm. To illustrate, if a partner issues a promissory note in the firm name and delivers it to his creditor in payment of a personal obligation, the latter acts at his peril because such an act may be a fraud upon the firm.[32]

(3) A third person must mark the discontinuance of a partnership relation, either when the partnership is terminated under conditions requiring no notice, or when notice of the termination has been properly given.[33]

(4) A third person must recognize and act in accordance with limitations which arise from the scope of the business. A partner cannot bind the firm to a third person in a transaction not within the scope of the firm's business unless he has express authority. Thus, when a member of a dental firm speculates in land, or a member of a firm dealing in automobiles buys horses, the third person, in the absence of estoppel or express authority, cannot hold the other partners on such a contract.[34] The scope of the business is a question of fact to be determined by the jury from the circumstances of each case. In general, it means the activities commonly recognized as a part of a given business at a given place and time. The usual scope, however, may be enlarged by agreement or by conduct.

(5) The third person must take notice of limitations arising out of the nature of the business. A partnership may be entered into for a particular kind of business, trade, or profession, and third persons are presumed to know the limitations commonly laid upon partners in such an enterprise. Thus an act of a partner which would ordinarily bind a commercial

[31] *Carr* v. *Hertz*, 54 N. J. Eq. 127, 33 A. 194.
[32] *Nichols* v. *Thomas*, 51 Okla. 212, 151 P. 847.
[33] *Post*, p. 650.
[34] *Pickels* v. *McPherson*. 59 Miss. 216.

firm, as the issuing of a note, would not bind a partnership engaged in a profession.[35]

It is important in this connection to note that a partner has much greater powers in a trading partnership than in a nontrading firm. A trading firm is one "whose conduct so involves buying and selling, whether incidental or otherwise, that it naturally comprehends the employment of capital, credit, and the usual instrumentalities of trade, and frequent contact with the commercial world in dealings which in their character and incidents are like those of traders generally." [36] A nontrading firm is one formed to engage in the pursuit of some occupation or profession. To illustrate, a partnership engaged in the practice of medicine or in farming is a nontrading firm.[37]

Powers Usually Implied. As the limitations which must be noticed by a third person have been observed, some of the usual powers of a partner will now be examined. It is impossible to discuss here all of the powers which may be incidental to every kind of business. There are, however, some powers of partners which are more or less common to all businesses.

(1) A partner in a trading or nontrading firm has the authority to compromise, adjust, and pay bona fide claims against the partnership. He may pay debts out of firm funds, or he may pay them by transferring the firm property to creditors. Although he has no power to pay his own debts from firm assets, his creditors are protected if they receive payment in good faith and without knowledge that it comes from firm assets. To illustrate, if the title to firm property is held by one partner, thus making it appear that it is his alone, and he transfers it to his creditor in satisfaction of a personal obligation, the transferee is protected.[38] The creditor is also protected when he is unaware that the partner is paying his personal obligation with firm money.

> "A member of a partnership is authorized to settle and adjust claims against the partnership." (Watkins v. Moore, 178 Ark. 350, 10 S. W. [2d] 850)

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[35] *Livingston* v. *Roosevelt*, 4 Johns (N. Y.) 251.
[36] *Marsh* v. *Wheeler*, 77 Conn. 449, 59 A. 410.
[37] *Woodruff* v. *Scaife*, 83 Ala. 152, 3 S. 311.
[38] *Locke* v. *Lewis*, 124 Mass 1.

(2) A partner in a trading or nontrading firm may adjust, receive payment of, and release debts and other claims of the firm. He may take money or negotiable instruments, but as a rule cannot accept goods in payment. One who makes a proper payment is protected, even though the partner to whom payment is made fails to account to the firm. Thus, when a third person who owes a debt to a partnership pays one of the partners and the partner uses the money for his own benefit, the firm cannot collect again from the third person.[39]

> The release of a claim in favor of the firm given by a partner was held to be within his implied authority. (170 Okla. 389, 40 P. [2d] 1050)

(3) A partner in a trading firm may borrow money for partnership purposes. In doing so, he may execute negotiable instruments in the firm name or give security, such as a mortgage or pledge of the personal property of the firm. If the third person acts in good faith, the transaction is binding even though the partner misappropriates the money. A partner in a nontrading partnership does not ordinarily possess these powers. To illustrate, if two doctors are in partnership to practice medicine, and one of them borrows money, executing a promissory note in the firm name, the other is not liable unless he consents or unless by custom a partner in this or similar firms has such power.[40]

> A partner had implied authority to borrow money and to give a chattel mortgage on firm property for purpose of carrying on the partnership business. (Maercklein v. Maercklein, 64 N. D. 733, 256 N. W. 180)

(4) A partner may sell in the regular course of business any part or all of the personal property of the firm, and make the usual warranties incidental to such sales. This authority, however, is limited to the goods kept for sale. Thus, when a partner in a firm established to manufacture chairs sells the tools which are used by the firm for this purpose, the partnership is not bound by the transaction.[41]

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[39] *Huffman Farm Co.* v. *Rush*, 173 Pa. 264, 33 A. 1013.
[40] *Croswait* v. *Ross*, 1 Humph. (Tenn.) 23.
[41] *Carrie* v. *Cloverdale Co.*, 90 Calif. 84, 27 P. 58.

(5) A partner may purchase any kind of property within the scope of the business, and for this purpose he may pledge the credit of the firm. This authority is not affected by the fact that he subsequently misuses the goods. To illustrate, if a partnership is formed for the buying and selling of horses, and one of the partners buys a horse on firm credit for his own use, the firm is nevertheless bound by the transaction.[42]

(6) A partner may insure the firm property, cancel a policy of insurance, or make proof and settle for the loss. Thus, when ten days before a loss one partner made an agreement with the company to surrender the policy, it was binding on the firm.[43]

(7) A partner may engage such employees and agents as are necessary to carry out the purposes of the enterprise. Thus one partner may make a binding contract for the services of a person to drive a vehicle used by the firm.[44]

(8) A partner may bind the firm by statements which are adverse to the interests of the partnership, if they are made in regard to firm affairs and in the pursuance of firm business. These statements may be in the form of declarations, representations, or admissions. The Uniform Partnership Act states that "an admission or representation made by any partner concerning partnership affairs within the scope of his authority as conferred by this act is evidence against the partnership." [45]

> A partner "cannot by his mere admission or declaration bring a transaction within the scope of the business when upon the facts in proof it appears to have no connection." (Caswell v. Maplewood Garage, 84 N. H. 241, 149 A. 746)

(9) A partner may make any contract necessary to the transaction of firm business. To illustrate, he can hire the use of personal property or make a lease of real property required for the firm business.[46]

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[42] *Clark* v. *Johnson*, 90 La. 442.
[43] *Hillock* v. *Traders Ins. Co.*, 54 Mich. 531, 20 N. W. 571.
[44] *Carley* v. *Jenkins*, 46 Vt. 721.
[45] §11.
[46] *Smith* v. *Cisson*, 1 Colo. 29.

(10) A partner may receive notice of matters affecting the partnership affairs, and such notice, in the absence of fraud, is binding on the others. Thus notice to one partner to quit the premises is notice to the firm.[47]

Powers Not Implied. It is likewise impossible to discuss all of the powers denied to partners in every kind of business activity. There are, however, several important powers which are uniformly denied and which deserve to be mentioned.

(1) A partner in most states cannot submit controversies of his firm to arbitration, because courts ordinarily are available for this purpose. The Uniform Partnership Act expressly denies this power "unless authorized by the partners or unless they have abandoned the business." [48]

> When the partners knew that the firm was a member of an association which required its members to arbitrate their differences, the managing partner had power to submit a controversy with another member to arbitration. (Chickasha Cotton Oil Co. v. Chapman, 4 F. [2d] 319)

(2) A partner has no implied authority to bind the firm by contracts of surety, guaranty, or indemnity for purposes other than the firm business. Thus he cannot bind the partnership as surety for himself or for strangers.[49]

(3) A partner cannot ordinarily make a general assignment of firm property for the benefit of creditors. Exceptions are usually provided for in cases of bona fide acts in an emergency. To illustrate, when his copartners have absconded, or for some reason cannot be consulted or give their consent, a partner may make such assignment. The exceptions appear to be limited by the Uniform Partnership Act which provides that "unless authorized by other partners or unless they have abandoned the business, one or more but less than all the partners have no authority to assign the partnership property in trust for creditors or on the assignee's promise to pay the debts of the partnership." [50]

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[47] *Walker* v. *Sharpe*, 103 Mass. 154; *Uniform Partnership Act*, §12.
[48] §9—3 (e).
[49] *Seeberger* v. *Wyman*, 108 Iowa 527, 79 N. W. 290.
[50] §9—3(a).

An absconding partner "is deemed to have, by implication, conferred on his partner sufficient authority to do those acts which the emergencies of the business may require." (Voshmik v. Hartmann, 91 Wis. 513, 65 N. W. 60)

(4) A partner cannot confess judgment against the firm upon one of its obligations, as all partners should have an opportunity to defend in court. This power is also expressly denied by the Uniform Partnership Act, except when the other partners consent or when "they have abandoned the business." [51]

(5) A partner cannot bind the firm by a contract which is outside the scope of his business, or by a contract which would make it impossible for the firm to conduct its usual business.[52]

(6) A partner as a general rule cannot bind his copartners by an instrument under seal. Thus the firm is not bound on a deed or bond executed by one partner.[53] Some states, however, hold that instruments under seal are binding upon the firm when they are made in the usual course of business. This view is adopted by the Uniform Partnership Act.[54]

(7) A partner cannot discharge his personal obligations or claims of the firm by interchanging them in any way. Thus he cannot discharge his personal obligation to a third person by accepting his own outstanding note in payment of a claim due to the firm.[55]

QUESTIONS

1. Hagen, who is a creditor of a partnership, sells his claim at a fifteen per cent discount to one of the members of the debtor firm. The other members of the partnership contend that the firm is entitled to the benefit of this transaction. Is their contention sound?

2. Purcell and Jensen are partners engaged in the retailing of paints and wallpaper. A claim that the firm has against a contractor for paint has become unenforceable because of the Statute of Limitations. Jensen contends that Purcell is liable to the firm for the loss because he failed to collect the debt. Do you agree?

3. Gordy, Kuhns, and Lyman form a partnership to manufacture toys. Unknown to Gordy and Kuhns, Lyman engages in the manufac-

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[51] §9—3(d).
[52] *Uniform Partnership Act*, §§9—(2) and 9—(3).
[53] *Moore* v. *Stevens*, 60 Miss. 809.
[54] §§9—(1) and 10.
[55] *Cotzhausen* v. *Judd*, 43 Wis. 213.

ture of overalls and gloves. When this fact is discovered, the partners claim that the profits of this business inure to the benefit of the firm. May Lyman be compelled to account to the firm for the profits?

4. A partner takes the firm's truck after business hours to move his furniture. While performing this task, he negligently runs into Miller's automobile. Miller compels the partner to pay for the damages incurred. The partner now claims that the other members of the firm must share the loss. Do you agree?

5. Larrimore, Purvis, and Stover agree to form a partnership and to contribute ten thousand dollars each to the capital of the firm. Later Larrimore advances five thousand dollars to meet some unexpected firm expenses. When this sum is returned, Larrimore contends that he is entitled to interest on the amount. Is his contention sound?

6. A clothing company sells a given quantity of clothes to Mason, one of the members of the firm, on credit for ninety days. Mason fails to pay the obligation when it falls due, and the firm brings an action at law to recover the purchase price. Is it entitled to judgment?

7. Two members of a firm refuse to allow the third partner to share in the management of the business or to inspect the books of the firm. What are the rights of the third partner?

8. Kerr, Gibboney, and Crawford form a partnership to sell automobiles. The Rolling Wagon Company offers the firm a dealer's contract to sell wagons. Crawford objects to the undertaking, but Kerr and Gibboney agree to enter into the contract. Crawford contends that the agreement does not bind him. Do you agree?

9. "A third person must take heed of certain limitations and restrictions on the authority of a partner." What is meant by this statement?

10. Bond and Henkle are partners in a trading firm. The former borrows five hundred dollars from a bank and executes a negotiable note in the firm name. He spends the money for his own purposes. May the bank hold Henkle on the note?

11. A member of a partnership sold the display cases for the firm's goods to Goad. His partner brought an action against Goad to recover the cases. Was the partner entitled to judgment?

12. A firm receives a bill of exchange in payment for some goods. The instrument is negotiated to pay the debt of the firm to the Amber Company. The note is dishonored at maturity, and the Amber Company gives due notice of dishonor to one of the partners. In the trial of an action on the note against the members of the firm, the partners contend that they are not liable because of lack of notice. Is this a valid defense?

13. Denaut and Hastings form a partnership to manufacture radio cabinets. Denaut executes a contract in the firm name, guaranteeing the remainder of a loan made by a bank to his nephew. Hastings contends that he is not liable on the contract. Do you agree?

Part IV—Liability of Partners

Liability of Partners. Frequently the question arises whether a partner is liable for certain acts of one or more members of the firm. It is clear that he should not be liable for every act of a copartner, and this fact is recognized by the law. It is equally clear that he should be held responsible for some acts of his copartners. Whether the act of one partner will bind his copartners depends largely upon the character of the act.

Contracts. All members of the firm are liable on contracts made by a partner for the partnership and in its name, if they were made within the scope of his actual or implied powers. This is true although the partners may be unknown to the third persons. Thus a dormant or a secret partner, when discovered, is bound equally with the others.[1] When the partner makes a simple contract in his own name for the firm, the other members are nevertheless liable, but it must be clear that the third person did not deal with the partner as an individual. To illustrate, a firm is not liable when a partner borrows money to make his contribution to the partnership capital.[2]

> When a surety company, with knowledge of a road construction partnership, elects to contract with a partner thereof on such partner's exclusive credit, the other partners are not liable on the contract. (Southern Surety Co. v. Plott, 28 F. [2d] 698)

The members of a firm are not liable on a contract under seal executed by one partner. Thus, if a member executes a bond or deed, his copartners are not liable on the instrument.[3] This is true on the grounds that all other obligations merge in such a formal obligation, and only the parties named therein can sue or be sued. In states in which the seal has lost its common-law significance, the partners would be liable on such instruments.

Torts. All members of the partnership are liable for torts, such as fraud, trespass, negligence, and deceit, committed by

[1] *Bisel* v. *Hobbs*, 6 Blackf. (Ind.) 479.
[2] *National Bank of Virginia* v. *Cringon*, 91 Va. 347, 21 S. E. 820.
[3] *Williams* v. *Gillies*, 75 N. Y. 197.

one partner while transacting firm business. Thus, when one partner wrongfully uses property of a third person, all members of the firm are liable if he was acting within the scope of the firm business.[4] The Uniform Partnership Act states that "where, by any wrongful act or omission of any partner acting in the ordinary course of the business of the partnership, or with the authority of his copartners, loss or injury is caused to any third person, not being a partner in the partnership, or any penalty is incurred, the partnership is liable therefor to the same extent as the partner so acting or omitting to act." [5]

> A partner, although having no knowledge of the fraudulent transactions of his partner, was liable for the fraud of such partner "within the scope of the common undertaking." (Philips v. United States, 59 F. [2d] 881)

The members of a firm are also liable for breach of trust by one or more partners in respect to goods or money held by the firm. To illustrate, when funds received by the firm for safekeeping are misappropriated by one partner, the members of the firm are answerable with the wrongdoer.[6] This rule is adopted by the Uniform Partnership Act "(a) where one partner acting within the scope of his apparent authority receives money or property of a third person and misapplies it; and (b) where the partnership in the course of its business receives money or property of a third person, and the money or property so received is misapplied by a partner while it is in the custody of the partnership." [7]

Nature of Partners' Liability. The obligations of partners may be joint or several. If an obligation is joint, all must be sued, for they have made no separate obligations; if the obligation is several, they may be sued jointly or separately. The partners are jointly liable on all firm contracts. Thus, when an action on a firm contract is brought against one member, he may defeat the particular action by objecting to the fact that his partners have not been joined with him as co-

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[4] *Hobbs* v. *Chicago Packing Co.*, 98 Ga. 576, 25 S. E. 584.
[5] §13.
[6] *Monmouth College* v. *Dockery*, 241 Mo. 522, 145 S. W. 785.
[7] §14.

defendants.[8] They are jointly and severally liable for all obligations arising out of torts by an employee or one of the partners. Thus, when one partner wrongfully injures a third person, the latter may sue all or any number of the members of the firm.[9] The Uniform Partnership Act states that "all partners are liable (a) jointly and severally for everything chargeable under 13 and 14 (torts and violations of trust), and (b) jointly for all other debts and obligations of the partnership; but any partner may enter into a separate obligation to perform a partnership contract." [10]

> A partner is not liable for the criminal acts of his associates "unless within the scope of the business." (United States v. Wilson, 59 F. [2d] 97)

When the partners owe a joint obligation, the party to whom it is owed labors under several disadvantages at common law. First, any one or more of the partners, if sued, may insist upon all being joined. Second, if the partners sued do not object to being sued by themselves and judgment is secured, the liability of the other members is extinguished on the theory that the entire cause of action becomes merged in the judgment. Third, a release of one of the partners will discharge the other members from liability. This rule also applies when the obligation of the partners is joint and several. It does not apply, however, when there is merely an agreement not to pursue one partner. To illustrate, if a creditor covenants not to sue one member of the firm, the other partners are not released.[11] In many states these common-law rules have been modified by statute.

Extent of Partners' Liability. A judgment rendered against the partners for firm claims may be enforced against all or one of the partners. In other words, each member of the firm is liable for the entire debts of the partnership, regardless of his interest in its management. Moreover, the individual property of one partner, even before the firm property has

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[8] *Mason* v. *Eldred*, 73 U. S. 231, 18 L. Ed. 783.
[9] *Howe* v. *Shaw*, 56 Me. 291.
[10] §15.
[11] *Berry* v. *Gillis*, 17 N. H. 9.

been exhausted, is subject to be seized and sold in satisfaction of the judgment. To illustrate, a creditor, after obtaining judgment for a claim against a firm having several members, may at once collect the entire amount from one partner, or, if necessary, require his private property to be sold to satisfy the judgment.[12] Whenever one partner is compelled to pay the entire obligation, he is not required, however, to bear the loss alone. Thus the partner from whom the creditor collects is entitled to demand that his copartners make a pro rata contribution to him.[13]

> "A partnership debt is in reality the individual debt of each of the individual members of the partnership and their liability thereon is a primary liability and not a secondary one." (Boeger & Buchanan v. Hagen, 204 Iowa 435, 215 N. W. 597)

The liability of a new partner entering an old firm is at common law only for obligations arising thereafter. He may, however, expressly or impliedly assume the existing liabilities. Thus, when a new firm takes over the assets of an old firm, courts may infer an agreement to pay existing obligations.[14] In other instances the agreement may be enforced by the creditors either because they are beneficiaries of the contract or because the agreement was made with them. The Uniform Partnership Act states that "a person admitted as a partner into an existing partnership is liable for all the obligations of the partnership before his admission as though he had been a partner when such obligations were incurred, except that his liability shall be satisfied only out of the partnership property." [15] This provision is a radical change in the law. The liability, however, does not extend to his individual property.

> A new partner in a firm conducting an ice rink business was held not liable personally for an old firm debt, the court applying the rule of the Uniform Partnership Act that the new partner's liability shall be satisfied only out of the firm property. (Geisenhoff v. Babrey, 58 Calif. A. [2d] 481, 137 P. [2d] 26)

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[12] *Stout* v. *Baker*, 32 Kans. 113, 4 P. 141.
[13] *Ante*, p. 625.
[14] *Wood* v. *Macafee*, 172 N. Y. S. 703.
[15] §17; also see §41—(1) and (7).

A partner remains liable, unless the creditors expressly release him, until the claims against the firm are satisfied. The Uniform Partnership Act states the following rules: "First, the dissolution of the partnership does not of itself discharge the existing liability of any partner. Second, a partner is discharged from any existing liability upon dissolution of the partnership by an agreement to that effect between himself, the partnership creditors, and the person or partnership continuing the business; and such agreement may be inferred from the course of dealing between the creditor having knowledge of the dissolution and the person or partnership continuing the business. Third, where a person agrees to assume the existing obligations of a dissolved partnership, the partners whose obligations have been assumed shall be discharged from any liability to any creditor of the partnership who, knowing of the agreement, consents to a material alteration in the nature or time of payment of such obligations." [16]

Actions against the Firm. It is important to know who should be the parties to an action by third persons against the firm. In the absence of statutes no action can be brought by or against a partnership in the firm name, except when courts treat the relation as an entity.

Contracts. When an action is brought on a contract against the firm, it is usually necessary to sue all ostensible partners. It is desirable, but not necessary, to join secret and dormant partners. Failure to join the necessary parties enables the ones sued to defeat the action on ground of nonjoinder of proper parties. They may, however, raise no objection. Thus, when two of three partners are sued by a creditor on a contract, they may defend the action or abate it on grounds of nonjoinder of the third member of the partnership.[17] This rule requiring joinder of all partners has been changed by statute in some states.

In some states under statutes "a partnership may be sued under the firm name." (Reuf v. Fulks, 219 Ala. 252, 122 S. 14)

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[16] §36.

[17] *Harrison* v. *McCormick*, 69 Calif. 616, 11 P. 456.

Torts. One bringing an action in tort against the firm, unlike an action in contract, need not join all of the ostensible partners as defendants. It should be recalled that when the partnership is bound by the wrongful act of an employee or of a partner, the liability of the members is usually joint and several. Thus, if a person is injured by an employee of a firm under such circumstances as to fix liability upon the firm, the injured party may either sue all of the partners or bring an action against any portion of the members.[18]

Actions by the Firm. When an action is brought by the firm against third persons, it is also important to know who are the proper parties to the action.

Contracts. When an action is brought by the firm against third persons on a contract, all ostensible members must as a general rule be plaintiffs. Secret and dormant partners need not be joined. If one of the necessary partners refuses to sue, he must be named as a defendant. In some states the partnership is permitted by statute to sue in its firm name. When the contract is made by one partner for the firm, the rule of joinder applies in the case of a simple contract, but not in the case of a contract known as a common-law or a mercantile specialty. Thus, when an action is brought by a firm on an instrument under seal or a negotiable instrument, it must be brought in the name of the partner or partners who are named in it.[19]

> A statute modifying the common law so that a partnership may be sued in its firm name, does not permit the partnership to sue in its firm name. (Ginsberg Tile Co. v. Farone, 99 Calif. A. 381, 278 P. 866)

Torts. When an action is brought against third persons for wrongful injuries sustained by the partnership, the rule is the same as in contract actions. All of the partners must join as plaintiffs. To illustrate, a person negligently runs his automobile against a car belonging to a partnership. One of the partners brings an action in tort against the wrongdoer.

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[18] *Hyrne* v. *Erwin*, 23 S. C. 226.
[19] *State* v. *Merritt*, 70 Mo. 275.

He cannot recover even for his share of the loss suffered by the firm on account of the injury to its property.[20]

QUESTIONS

1. Morrey and Hilgard enter into a partnership for the purpose of selling hay and grain. The former agrees to contribute eight thousand dollars, and the latter five thousand dollars to the firm capital. The sum contributed by Hilgard is borrowed from Milgren. When Hilgard fails to repay the loan, Milgren brings an action against both Morrey and Hilgard. Is he entitled to judgment against Morrey?

2. Rainey and Chilko are partners. The latter, in attempting to satisfy a judgment which the firm has against Libbey, levies on the property belonging to Stimson. Stimson brings an action of trespass against Rainey and Chilko. Is he entitled to judgment against Rainey?

3. Milroy agrees to purchase eight hundred bushels of wheat from a firm composed of Timms, Hill, and Royden. The firm delivers only four hundred bushels of wheat, and Milroy brings an action for damages against Timms and Hill. Is he entitled to judgment?

4. Kerr brought an action and recovered a judgment against Child and Norse, who were partners in a firm of three members. Thereafter Kerr brought an action on the same debt to recover from the third member of the firm. Was he entitled to judgment?

5. A boy, employed by a firm to make deliveries, negligently drives his truck upon Dobbs's lawn causing an injury to several small trees. Dobbs brings an action for damages against one of the members of the firm. Is he entitled to judgment?

6. Tilden and Collins are partners. Doyle, a creditor of the firm, sues the partners and obtains a judgment for the amount of his credit. The judgment debt remains unpaid, and Doyle threatens to seize and sell Tilden's personal property to satisfy the judgment. May he do so?

7. Young and Drang, partners, purchased certain goods on credit from the Empire Commission Company. Thereafter Turner entered the partnership. The commission company attempted to hold Turner liable for the foregoing obligation. Was it entitled to do so?

8. Rutherford withdraws from a partnership with Ellert. The latter agrees to assume all the existing debts of the firm. Later Ellert obtains an extension of time on a firm's note held by Werner. The note is not paid when due, and Werner seeks to hold Rutherford and Ellert for payment. Is Rutherford liable on the note?

9. Burns and Foster are partners engaged in selling rugs. Burns on behalf of the firm accepts a negotiable promissory note payable to himself in payment for a rug. The note is not paid at maturity. In whose name should the action be brought against the maker?

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[20] *White* v. *Campbell*, 18 R. I. 150, 26 A. 40.

Part V—Dissolution and Termination

By Acts of Parties. Partnerships are usually dissolved by acts of the parties. In such cases the dissolution may be agreed upon or may be against the wishes of one or more members. Dissolution by acts of parties may occur in one of several ways.

Agreement. A partnership may be dissolved by virtue of the original agreement of the parties. To illustrate, it is dissolved by the passing of the period for which the relation was to continue or by the performance of the object for which it was organized.[1] The relation may also be dissolved by subsequent agreement, as when the partners agree to dissolve the firm before the elapse of the time specified in the articles of partnership, or before the attainment of the object for which the firm was created.

> The fact that partners of a firm, organized for purpose of raising wheat, agreed to pay the expenses of a crop out of their own funds did not dissolve the partnership. (Reid v. Linder, 77 Mont. 406, 251 P. 157)

Withdrawal. One partner may at any time refuse to continue and may withdraw. The law does not compel one to be or to remain in this relation. If a partner, however, exercises his power to withdraw in a manner contrary to his agreement, he becomes liable to his copartners for damages. When the relation is for no definite purpose or time, a partner may withdraw without liability at any time, unless a sudden withdrawal would do irreparable damage to the firm.

> "Every change in the personnel of a partnership, such as the withdrawal of a member or admitting a new one, works a dissolution." (Harwell v. Cowan, 175 Ga. 33, 165 S. E. 19)

Alienation of Interest. The withdrawal of a partner need not be formally and expressly made. It is sufficient if he does an act which unmistakably evidences his intention to discontinue the relation. Thus a dissolution is usually effected if one partner sells or assigns his interest in the business.[2] The

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[1] *Uniform Partnership Act*, §31—1(a).
[2] *Carter* v. *Roland*, 53 Tex. 540.

Uniform Partnership Act, however, states that "a conveyance by a partner of his interest in the partnership does not of itself dissolve the partnership." [3] An involuntary sale for the benefit of creditors has usually been considered sufficient to work a dissolution of the partnership. This result, however, is avoided by the provisions of the Uniform Partnership Act.[4]

> Although a sale of one partner's interest does not necessarily dissolve the firm, "the purchaser does not thereby become a partner," but is entitled only to recover under his agreement "the profits to which the assigning partner would otherwise be entitled." (Hammond Oil Co. v. Standard Oil Co. of N. J., 259 N. Y. 312, 181 N. E. 583)

Expulsion. Although the members of a firm have no right to expel any partner, they may agree that upon certain conditions a partner can be enforced to withdraw. The Uniform Partnership Act provides for dissolution "by the expulsion of any partner from the business bona fide in accordance with such a power conferred by the agreement between the partners." [5]

By Operation of Law. Upon the happening of certain events a partnership will be dissolved by operation of law. These events give rise to the impossible, undesirable, or illegal continuance of the relation.

Death. An ordinary partnership is dissolved immediately upon "the death of any partners." [6] This is true, in spite of statements by some courts to the contrary, even when the agreement provides for continuance in some form. Thus, when the executor of a deceased partner carries on the business with the remaining partner, there is really a new firm.[7]

> A provision in the partnership agreement that a deceased partner's estate was to receive a share in the firm income for one year after death, "did not and could not keep the partnership in existence with a dead man as a partner." (Darcy v. Commissioner of Internal Revenue, 66 F. [2d] 581)

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[3] §27.
[4] §28.
[5] §31—1(d).
[6] *Uniform Partnership Act*, §31—4.
[7] *Schmidt* v. *Archer*, 113 Ind. 365, 14 N. E. 543.

Bankruptcy. Bankruptcy of one of the partners also causes the dissolution of the firm. The Uniform Partnership Act provides that the bankruptcy of the partnership dissolves the firm.[8] Mere insolvency of one or more partners does not dissolve a firm.

War. A firm is ordinarily dissolved when there is war between governments to which the partners owe allegiance. The rule also applies to war between parts of one nation. Thus, when the partners of a firm were divided as enemies during the Civil War, the relation was dissolved.[9]

> When a firm had members who were citizens of Germany and of the United States, "the declaration of a state of war immediately affected a dissolution of the partnership." (Sutherland v. Mayer, 271 U. S. 272, 70 L. Ed. 943)

Illegality. A partnership is dissolved "by any event which makes it unlawful for the business of the partnership to be carried on or for the members to carry on in partnership." [10] To illustrate, when it is by statute made unlawful for judges to engage in the practice of law, a law firm is dissolved when one of its members becomes a judge.[11]

By Decree of Court. When a partnership is to continue for a certain time, there are several situations in which one partner is permitted to seek the dissolution through the intervention of the court. In such cases an application for that purpose must be made to a court of equity, as courts of law do not have jurisdiction under such circumstances. Events which justify a dissolution may occur before, but usually occur after, the formation of the relation. The causes which enable a partner to ask for a dissolution under the common law have been substantially codified by the Uniform Partnership Act.[12]

Insanity. A partner may obtain a decree of dissolution when his partner has been judicially declared a lunatic or when it is shown that he is of unsound mind.

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[8] *Uniform Partnership Act*, §31—3.
[9] *Wood* v. *Wilder*, 43 N. Y. 164.
[10] *Uniform Partnership Act*, §31—3.
[11] *Justice* v. *Lairy*, 19 Ind. A. 272, 49 N. E. 459.
[12] §32—1.

Incapacity. A decree of dissolution will be granted when one partner becomes in any way incapable of performing the terms of the partnership agreement. For example, a serious injury to one partner making it physically impossible for him to do his part is a cause for dissolution.[13]

Misconduct. A partner may obtain a decree of dissolution when his partner has been guilty of conduct which tends prejudicially to affect the continuance of the business. Thus the habitual drunkenness of a partner is a sufficient cause for judicial dissolution.[14]

> "A partnership will not be dissolved for trifling faults and misbehavior of one of the partners, which do not go to the substance of the contract." (Green v. Kubik, 213 Iowa 763, 239 N. W. 589)

Impracticability. A partner may obtain a decree of dissolution when another partner habitually or purposely commits a breach of the partnership contract or so conducts himself in matters relating to the partnership business that it is not reasonably practicable to carry on the business in partnership with him. To illustrate, if one partner is dishonest in his affairs, the other may demand a termination of the relation.[15]

Lack of Success. A decree of dissolution will also be granted when the business of the partnership cannot be continued except at a loss. Thus, if the object of the relation becomes impossible to attain, a decree of dissolution will be granted, for in such case there is no reason to continue.[16]

Equitable Circumstances. A decree of dissolution will be granted under any other circumstances which equitably call for a dissolution. A situation of this kind, for example, occurs when one partner is induced by fraud to enter into partnership.[17]

Effect of Dissolution. Dissolution involves a change in the relation of the partners, but does not end the partner-

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[13] *Raymond* v. *Vaugh*, 128 Ill. 256, 21 N. E. 566.
[14] *New* v. *Wright*, 44 Miss. 202.
[15] *Cottle* v. *Leitch*, 35 Calif. 434.
[16] *Holloday* v. *Elliott*, 8 Oreg. 84.
[17] *White* v. *Smith*, 63 Ark. 513, 39 S. W. 555.

ship. The Uniform Partnership Act expressly states that "on dissolution the partnership is not terminated, but continues until the winding up of the affairs." [18] The vested rights of the partners are not extinguished by dissolving the firm, and the existing liabilities remain. Thus, when the relation is dissolved by the death of a partner, the estate of the deceased member is liable for the then existing debts of the firm.[19]

> When Gleason withdrew from a firm, composed of himself, Sork, and Ingber, trading as Lawton Diner No. 3, "the withdrawal of Gleason from the partnership dissolved it, but such a dissolution does not terminate the partnership." (Sork v. C. Trevor Dunham, Inc., 107 Pa. Super. 77, 163 A. 315)

The dissolution, however, does affect the authority of the partners. From the moment of dissolution the partners are sheared of all authority to act in behalf of the firm, "except so far as may be necessary to wind up partnership affairs or to complete transactions begun but not finished." [20] Thus one partner cannot bind his copartners, as between themselves, after a proper dissolution by issuing a note in the firm name.[21]

Notice of Dissolution. The rule that dissolution terminates the authority of the partners to act for the firm requires some modification. Under some circumstances one partner may possess the power to make a binding contract. When the firm is dissolved by an act of a partner, notice must be given to the partners, unless it is self-evident. To illustrate, when one partner withdraws without notice to the partners of his intent, he is bound as between them upon contracts created for the firm.[22] The Uniform Partnership Act declares that "where the dissolution is caused by the act, death, or bankruptcy of a partner, each partner is liable to his copartners for his share of any liability created by any partner acting for the partnership as if the partnership had not been dissolved, unless (a) the dissolution being by the act of any

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[18] §30.
[19] *Mason* v. *Tiffany*, 45 Ill. 392.
[20] *Uniform Partnership Act*, §33.
[21] *White* v. *Tendor*, 24 Tex. 639.
[22] *Egle* v. *Bucher*, 6 Ohio St. 295.

partner, the partner acting for the partnership had knowledge of the dissolution, or (b) the dissolution being by the death or bankruptcy of a partner, the partner acting for the partnership had knowledge or notice of the death or bankruptcy." [23]

> An action by a partner to dissolve the partnership and for an accounting is sufficient notice of dissolution. (Blomquist v. Roth, 173 Wash. 79, 21 P. [2d] 279)

Under some circumstances the partner may have the power to make contracts binding on the partners, although he does not have authority to make the contracts. When dissolution is caused by the act of a partner, notice must be given to third persons. Actual notice must be given to persons who have dealt with the firm, as by giving credit. To persons who know of the relation, but have had no dealings with the firm, a publication of the fact is sufficient whether or not such persons get actual notice. Such notice may be by newspaper publication, by posting a placard in a public place, or by any similar methods.[24] Failure to give proper notice empowers each partner to bind the others in respect to third persons on contracts within the scope of the business.

When dissolution has been caused by operation of law, notice is not required. Thus, when the firm is dissolved by death or bankruptcy, involving a public proceeding, creditors are bound thereby regardless of notice.[25] This rule appears to be modified to some extent by the Uniform Partnership Act, which clearly makes a change in respect to death and bankruptcy as between the partners.[26]

Winding up Affairs. Although the partners after dissolution have no authority to create new obligations, they retain authority to do such acts as are necessary to close up the business. To illustrate, after dissolution one partner has authority to receive notice that a bill of exchange has been dishonored.[27] With a few exceptions, all partners have the right to participate in the winding up of the business. The

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[23] §34.
[24] *Ellison* v. *Sexton*, 105 N. C. 356, 11 S. E. 180.
[25] *Eustix* v. *Bolles*, 146 Mass. 413, 16 N. E. 286.
[26] §§34 and 35.
[27] *Hubbard* v. *Mathews*, 54 N. Y. 43.

Uniform Partnership Act provides that "unless otherwise agreed the partners who have not wrongfully dissolved the partnership, or the legal representative of the last surviving partner, not bankrupt, has the right to wind up the partnership affairs; provided, however, that any partner, his legal representative, or assignee, upon cause shown, may obtain winding up by court." [28]

> In some cases of dissolution by agreement, the partners may agree upon a liquidator who is to collect assets and to pay the bills of the firm. (Stubbe v. Cordova, 23 F. [2d] 257)

When the firm is dissolved by the death of one partner, the surviving partners take legal title to the personal property. Title to real property passes to the heirs of the partners in whom it was vested. The surviving partners, however, have power to subject it to firm uses. Thus the surviving partners in equity may compel the heirs to hold such property for the purpose of liquidating the firm debts.[29] The surviving members of a firm must collect and preserve the assets, pay the debts, and with reasonable promptness make an accounting to the representative of the deceased partner. In connection with these duties, the law requires the highest degree of integrity. Thus a partner in performing these acts cannot sell to himself any of the partnership property.[30]

Distribution of Assets. Creditors have first claim on the assets of the partnership. Difficulty arises in cases in which there is a contest between the firm creditors and the individual creditors. The general rule is that firm creditors have first claim on assets of the firm, and the individual creditors shares in the remaining assets, if there are any. Thus, when a partner's individual creditors levy upon a partner's interest in the firm, they are entitled to satisfaction only after levies even subsequently made by firm creditors are satisfied.[31] Likewise, individual creditors take priority in the distribution of

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[28] §37.
[29] *Shanks* v. *Klein*, 104 U. S. 18, 26 L. Ed. 635.
[30] *Denholm* v. *McKay*, 148 Mass. 434, 19 N. E. 551.
[31] *Bullock* v. *Hubbard*, 13 Calif. 626.

individual assets; the claims of the firm creditors may be satisfied after their claims are settled. These rules have been followed in most states and have been adopted by the Uniform Partnership Act.[32]

After the liabilities of the firm to nonpartners have been paid, the assets of the partnership are distributed as follows:[33]

(1) Each partner is entitled to a refund of advances made to or for the firm.

(2) Contributions to the capital of the firm are then returned.

(3) The remaining assets, if any, are divided equally as profits among the partners, unless there is some other agreement.

If the partnership has sustained a loss, the partners share it equally, as in the case of profits, in the absence of a contrary agreement.

QUESTIONS

1. Gerber and Sandburg form a partnership for a period of three years. At the end of the second year Gerber notifies Sandburg of his intention to withdraw from the firm. The latter contends that Gerber cannot dissolve a partnership until the expiration of the agreed time. Is Sandburg's contention sound?

2. Tucker and Harris are partners in the hardware business. Harris owes a large personal debt to Amer. Upon Amer's demand for payment Harris offers to assign his interest in the partnership to him in satisfaction of the debt. Amer refuses the offer on the ground that the transaction would dissolve the firm. Is his point well made?

3. Upon the death of a partner the executor carries on the business with the other members of the firm. Donnelly sold goods on credit to the firm before the death of the partner, and Veeder became a creditor after the partner's death. Are Donnelly and Veeder creditors of the same firm?

4. Bates and Hoppes form a partnership to engage in banking. A statute is enacted in the state declaring that it shall be unlawful for any individual or association of individuals, except corporations created for that purpose, to engage in the business of banking. Does this legislation affect the partnership between Bates and Hoppes?

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[32] §40—(h).
[33] *Uniform Partnership Act*, §89—(b).

5. Ancker and Hanrath form a partnership for ten years to practice surgery. One evening, while returning from a country club, Hanrath meets with a serious automobile accident. Later it is necessary to amputate both of his arms. Under these circumstances may Ancker obtain a decree of dissolution in the court of equity?

6. The terms of a partnership between Kelvyn and Fender stipulate that the management of the business is delegated solely to Kelvyn. Nevertheless, Fender at various times discharges employees of the firm and executes contracts on behalf of the firm. Kelvyn petitions for a dissolution of the partnership. Is he entitled to a degree of dissolution?

7. "Dissolution involves a change in the relation of the partners, but it does not end the partnership." What is meant by this statement?

8. Cahn, Perrin, and Osborn are partners. Cahn decides to retire from business and notifies Perrin of his withdrawal from the firm. Osborn, who is not in the city, executes a contract for the firm after Cahn's withdrawal. Cahn contends that as between the partners he has no liability on the contract. Is his contention sound?

9. Forsgon, Metcalf, and Wheeler were partners. Metcalf withdrew from the firm. Thereafter Forsgon entered into a contract with the Apex Company. Was Metcalf liable on this contract to the Apex Company?

10. Stetson enters into a partnership for a period of six years. At the end of two years he withdraws without good cause. He contends that he is entitled to assist in winding up the affairs of the partnership. Do you agree?

11. Logan and Hattis are partners. The former contributed twenty thousand dollars to the capital of the firm, and the latter ten thousand dollars. Logan subsequently advanced ten thousand dollars to the firm. Upon the dissolution of the partnership there remained only twelve thousand dollars after paying all outstanding obligations. Hattis contends that he is entitled to six thousand dollars. Do you agree?

CASES FOR REVIEW

1. Shiro Nakamura and Masaharu Kondo were partners doing business under the firm name of the M-K Fisheries Company. Nakamura brought an action against Kondo for a dissolution of the partnership and an accounting. He contended that an advance of the sum of $11,595.87, which he had made to the firm, should be repaid to him before the assets of the partnership were distributed to the partners. Do you agree with this contention? (Nakamura v. Kondo, 65 Calif. A. 211, 223 P. 425)

2. James Clark, T. P. Smart, and F. P. Murray were partners doing business under the firm name of Clark, Smart & Company. Smart settled a claim under a contract with the Slate Valley Railroad Company. Thereafter Clark and Murray, against the wishes of Smart, authorized De Forrest Ballou, an attorney, to prosecute an alleged claim against the railroad company. In the action brought against the company, it was contended that it was necessary to have the consent of all the members of the firm to prosecute the action. Do you agree? (Clark v. Slate Valley R. Co., 136 Pa. 408, 20 A. 562)

3. A. L. Alphin and E. H. Smith, who were partners, owed the sum of $593.50 to the Bank of El Dorado, Arkansas. Alphin paid the sum of $300 to the bank for application on the debt. Thereafter C. W. Dodson, as receiver for the bank, brought an action against Alphin to recover the remainder of the obligation. It was contended that an obligation of the firm could be collected from the assets of one partner alone. Do you agree? (Dodson v. Alphin, 88 Ark. 482, 115 S. W. 371)

4. E. M. Metcalf and others, of Kansas City, Missouri, purchased an interest in an oil lease on lands in Kansas from Ross. While awaiting the incorporation of a company to be known as the Happy Holler Oil & Gas Company, they made it appear that they and Ross were partners. Relying thereon, the Oil Well Supply Company sold certain goods upon the order of Ross. In an action brought by the seller against Metcalf and the others as partners, the defendants contended that they were not in fact partners and that they would not have gone into the transaction except for the false representations by Ross. Was the Oil Well Supply Company entitled to judgment? (Oil Well Supply Co. v. Metcalf, 174 Mo. A. 555, 160 S. W. 897)

5. Ison Warren and others, partners doing business under the firm name of Warren, Killiam & Cox, sold certain hogs to a firm composed of E. B. Haley and R. L. Hood. They warranted the hogs to be in good condition, but the buyers alleged that the animals proved to be unsound. Thereafter Hood brought an action against the sellers to recover damages for breach of warranty. Assuming that there had been a breach of warranty, was Hood entitled to judgment? (Hood v. Warren, 205 Ala. 332, 87 S. 524)

6. T. P. Judson, Solomon Abraham, and others were partners doing business under the firm name of Grant's Pass Real-Estate Association. H. B. Miller and his wife, C. K. Chancellor, and Joseph Moss conveyed to the firm in the name of the partnership certain land located in Grant's Pass, Oregon. Thereafter they conveyed the same land to John F. Kelley, who brought an action against Jonathan Bourne, Jr., to quiet title to the property. Kelley contended that the conveyance to the firm in the partnership name did not pass title under the common law. Do you agree? (Kelley v. Bourne, 15 Oreg. 476, 16 P. 40)

7. J. F. Beasley and R. A. Simpson were partners doing business under the name of J. F. Beasley Lumber Company. They were engaged in operating a lumber yard in Hot Springs, Arkansas, for the sale of lumber and other building materials. Beasley entered into a contract in the firm name with Mrs. M. M. Sparks to construct a frame, three-story building for an agreed sum. Thereafter Beasley contended that the contract did not bind the firm. Do you agree with this contention? (J. F. Beasley Lumber Co. v. Sparks, 169 Ark. 640, 276 S. W. 582)

8. Claude Eme and his son, Julius, were partners doing business as insurance, real estate, and loan brokers, under the firm name of Eme & Son. Julius Eme indorsed the firm name on a note purporting to be made by Mrs. Elizabeth Kanning and delivered the instrument for cash to August Schele. The name of Mrs. Kanning, as maker of the note, had been forged. In an action brought by Schele against Henry Wagner, as administrator of the estate of Claude Eme, a question arose as to the classification of the partnership. How should the firm be classified? (Schele v. Wagner, 163 Ind. 20, 71 N. E. 127)

9. J. L. Murray and P. L. Lance were partners in a mercantile business in Asheville, North Carolina, under the firm name of Lance & Murray. Murray withdrew from the firm, but notice of such fact was not given. Believing that Murray was still a member of the firm, K. F. Alexander rented a storehouse for the goods of Lance & Murray. In an action for the rent brought by Alexander against the executors of the estate of Murray and Lance, Alexander contended that Murray was liable for the firm obligation. Do you agree? (Alexander v. Harkins, 120 N. C. 452, 27 S. E. 120)

10. E. Coppieters, J. T. McCormick, and St. John McCormick were partners doing business in San Francisco, California, under the firm name of the California Artistic Metal & Wire Company. Their employee, Martin Johnson, rendered them liable for damages by negligently causing a piece of iron to fall upon and kill Murphy, a plumber, who was working below him. In an action brought by Mrs. Julia Murphy to recover damages, it was contended that the partners were severally and not jointly liable for the injury. Do you agree? (Murphy v. Coppieters, 136 Calif. 317, 68 P. 970)

11. The Republican Publishing Company, of Brokenbow, Nebraska, transferred a complete publishing outfit to J. H. Chapman under an agreement whereby it was to receive a portion of the profits of the business for the use of the outfit. Thereafter Chapman printed an alleged defamatory article in respect to E. O. Garrett. In an action brought by Garrett against the Republican Publishing Company and Chapman, Garrett contended that the defendants were partners. Was his contention sound? (Garrett v. Republican Publishing Co., 61 Nebr. 541, 85 N. W. 537)

12. Russel T. Dobson, Henry A. Whitaker, and Charles F. Kyer were partners doing a wholesale grocery business in the city of Ann Arbor, Michigan, under the firm name of Kyer-Whitaker-Dobson Company. Dobson sold his interest in the partnership to his partners. During subsequent litigation, it was contended that a partner's interest in firm property was neither that of a tenant in common nor that of a joint tenant. Do you agree with this contention? (Dobson v. Whitaker, 242 Mich. 308, 218 N. W. 770)

13. George Tuttle and Bethel Bristol entered into an oral agreement to form a partnership. Under the terms of the agreement, Tuttle was to obtain part of an interest of Bristol in certain land principally valuable for the timber thereon, located in Kalkaska County, Michigan. Bristol repudiated the agreement. Thereafter, Tuttle brought an action against Bristol to recover on the firm agreement. Was he entitled to judgment? (Tuttle v. Bristol, 142 Mich. 148, 105 N. W. 145)

14. William P. W. Haff and his son, Harmon B. W. Haff, were partners engaged in the wholesale coal business. The partnership agreement provided that the firm was to continue for sixty days after either party had given notice of an intention to withdraw. In an action brought by Mandella Mae Cahill, as executrix of the estate of William P. W. Haff, it was contended that the firm could have been dissolved by the withdrawal of one of the members at any time before the lapse of sixty days after notice. Do you agree? (Cahill v. Haff, 248 N. Y. 377, 162 N. E. 288)

15. O. Kittilsby and Sverre Velvelstad were partners doing work on a mining claim known as the Sea Level Claim. Kittilsby did the assessment work for one year and then went to Seattle, Washington, upon the promise of Velvelstad to do the work for the following year. Velvelstad did not do the work, and the claim became open to location. Velvelstad procured Singleton, who was to act for him, to locate and prove a claim covering the same district. After Singleton had conveyed the claim to him for a nominal consideration, Velvelstad sold the claim to the Juneau Sea Level Copper Mines. Thereafter Kittilsby brought an action against Velvelstad to recover half of the proceeds of the sale. Was he entitled to judgment? (Kittilsby v. Velvelstad, 103 Wash. 126, 173 P. 744)

16. Steve Benza and Teofil H. Grabowski were partners engaged in the chicken business. One day Grabowski wrongfully took and withheld possession of certain goods belonging to Benza for a period of several days. Thereafter Benza brought an action against Grabowski to recover damages in an action at law. It was contended that Benza was not entitled to bring such an action against his partner. Do you agree with this contention? (Grabowski v. Benza, 80 Ind. A. 214, 140 N. E. 76)

17. Joseph Van Orden possessed a permit to operate a bus between the city of Paterson, New Jersey, and the borough of Prospect Park. Pelligrino Cerino brought an action against Van Orden for an accounting of partnership profits. He alleged that he and Van Orden had formed a partnership to operate the bus under the permit issued to Van Orden by the governing body of Paterson. If his allegation proved to be true, was Cerino entitled to judgment? (Cerino v. Van Orden, 98 N. J. Eq. 7, 129 A. 704)

18. Jacob E. Erickson, Nettie C. Erickson, and Michael Collins were partners engaged in business under the firm name of Erickson & Collins. Without the knowledge or consent of his partners, Collins executed a chattel mortgage on certain personal property of the firm to secure a partnership debt owed to A. T. Rock. During subsequent litigation, it was contended that Collins did not have the power to bind the firm by such a mortgage. Do you agree? (Rock v. Collins, 99 Wis. 630, 75 N. W. 426)

19. John Ryan, who held by contract the exclusive right to sell Maxwell automobiles in certain townships of Madison County, Indiana, formed a partnership for one year with William E. Barnes for the purpose of selling the cars. About six months later, Ryan sold the exclusive right to sell the machines to other persons. Thereafter Barnes brought an action against Ryan, contending that the firm had been dissolved. Do you agree with his contention? (Ryan v. Barnes, 72 Ind. A. 152, 125 N. E. 643)

20. James E. Wisner and William H. Field were partners doing business under the firm name of Field & Wisner. The partnership agreement made no provision for compensation being paid to either of the partners. After some time had elapsed, Wisner contended that he was entitled to a commission on the sales of land which he had made in the conduct of the business of the firm. Was this contention sound? (Wisner v. Field, 11 N. D. 257, 91 N. W. 67)

21. Frank F. Foster, W. H. Coon, and Cornelius Burke were partners engaged in selling farm implements at Harbor Springs, Michigan, under the firm name of the Harbor Springs Implement Company. They were also engaged in selling threshing machines on commission. Coon wrongfully disposed of a machine that was in the possession of the firm for sale. The owner brought an action to hold the members of the firm liable

for Coon's wrongful act. Was the owner entitled to judgment? (Brown v. Foster, 137 Mich. 35, 100 N. W. 167)

22. Mack Farkus and others were partners doing business under the firm name of "Estate of Sam Farkus." They sold a black mule to L. R. Goodman under a conditional bill of sale. Thereafter the Farmers' & Merchants' Bank levied on the mule to satisfy a debt owed to it by Goodman. In an action brought by the members of the firm against the bank, it was contended that under the common law the name of the partnership was improper. Do you agree? (Farmers' & Merchants' Bank v. Farkus, 27 Ga. A. 153, 107 S. E. 610)

23. Charles Hipplehaus and William Chambers were partners doing business as bakers and confectioners under the firm name of Hipplehaus & Chambers. A claim against them was asserted by the Davenport Mills Company. Hipplehaus, without the knowledge or the consent of Chambers, confessed judgment for the amount of the company's claim. Thereafter Chambers brought an action to restrain the company from collecting on the judgment. Was Chambers entitled to judgment? (Davenport Mills Co. v. Chambers, 146 Ind. 156, 44 N. E. 1109)

24. S. Lesser entered into a contract with Inman & Company, in which firm James R. Gray was a partner. The agreement called for the delivery at stipulated times of certain bagging material, known as "patches," for use in the baling of cotton. In an involuntary proceeding, the partnership was adjudged a bankrupt. Thereafter in an action brought by Lesser against Gray, it was contended that the partnership had been dissolved. Do you agree? (Lesser v. Gray, 8 Ga. A. 605, 70 S. E. 104)

25. J. F. Laboon and J. T. Campbell were employed by J. H. Chester and Thomas Fleming, Jr., engineers and partners, trading as Chester & Fleming. They received a share of the profits of the business as wages. Did this fact make them partners in the firm? (City of Wheeling v. Chester, 134 F. [2d] 759)

26. Harry Swirsky and Irwin Horwich were equal partners in an auto repair business. After the death of Horwich in 1940, the surviving partner brought an action with respect to the firm property. It was contended that the interest of a partner in firm property was neither that of joint tenants nor that of tenants in common. Do you agree? (Swirsky v. Horwich, 382 Ill. 468, 47 N. E. [2d] 452)

27. An action was brought by a member of a partnership, which involved the property of the firm. It was asserted that at common law "real estate was held by an individual for the benefit of the partnership," because a partnership "could not hold the title." Was this contention sound? (Craik v. United States, 31 F. Supp. 132)

CHAPTER XI

CORPORATION AND STOCKHOLDERS

Part I—General Considerations

Introduction. The corporation is one of the most important forms of business units in use today. Other forms may outnumber it, but most business is transacted by units of this type. It is the only form of business unit suitable for the establishment and conduct of the great enterprises of modern business. Modern industries of gigantic proportion are dependent upon means of accumulating large sums of money from many persons, the continued existence of the unit, and the concentration of management in the hands of a relatively small group of qualified persons.

Although corporations are of ancient origin, their role in the business world is a matter of recent development. The expansion of industry during the latter half of the nineteenth century contributed largely to the wide adoption of the corporate form of organization. Large-scale production and world-wide markets demanded a business unit with facility for collecting capital, with managerial ability, and with assurance of existence beyond that possessed by the individual members.

A person may come in contact with corporations as a member or an employee, or through business transactions. It is scarcely possible for a person to avoid contacts of the latter type. In any case some knowledge of the rules, standards, and principles of law governing this form of business unit is desirable. Particularly the members of a corporation and the parties dealing with it should be interested in questions involving its creation, its powers, the rights and liabilities of the members, the method of conducting its business, and the modes and effect of dissolution.

Definition. There are many definitions of corporations, varying slightly, but they are usually inadequate unless stated at such length as to be confusing. An organization of per-

sons endowed by law to act, within certain limits, as a natural person, is known as a *corporation.* The unit is said to be "an artificial being, invisible, intangible, and existing only in contemplation of law." [1] As an aid to a proper understanding of this form of business unit, two important features of it will be noted.

> "A syndicate is not a corporation and in character is somewhat like a joint adventure." (Nowland Realty Co. v. Commissioner of Internal Revenue, 47 F. [2d] 1018)

Probably the most important characteristic of a corporation is the fact that the body continues to exist irrespective of changes in its membership. Unlike a partnership, the unit does not terminate with the death or withdrawal of one or more members, or with the admission of new members. Another important characteristic of a corporation is that its identity is separate and distinct from that of the members. It holds property, is sued and sues in its own name, and, in general, is solely liable for its obligations.

Chief Justice Marshall, referring to the properties possessed by a corporation, stated: "Among the most important are immortality, and, if the expression may be allowed, individuality; properties by which a perpetual succession of many persons are considered as the same, and may act as a single individual. They enable a corporation to manage its own affairs, and to hold property without the perplexing intricacies, the hazardous and endless necessity, of perpetual conveyances for the purpose of transmitting it from hand to hand. It is chiefly for the purpose of clothing bodies of men in succession with these qualities and capacities that corporations were invented, and are in use. By these means, a perpetual succession of individuals are capable of acting for the promotion of the particular object, like one immortal being." [2]

Power to Create. Individuals cannot, merely by agreement, form a corporation as they can a partnership. They can only do this with the express or implied authority of the

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[1] *Dartmouth College* v. *Woodward,* 4 Wheat. (U. S.) 518, 4 L. Ed. 629.

government. In this country the power to create corporations resides in the legislature. This power cannot be delegated, although ministerial acts in respect to it may be bestowed upon judicial or administrative officers.

> "Only a sovereign authority can create a corporation." (In re Lloyds of Texas, 43 F. [2d] 383)

Federal Power. Congress has only such powers as are granted in the Constitution, and the terms thereof do not expressly provide the power to create corporations. Congress may, however, create corporations in three instances. First, as the legislature of the District of Columbia it may create corporations within the district. Second, Congress may create corporations within the territories, under its power to make rules and regulations for their government, although it usually confers the power upon the legislatures of the territories. Third, it may create any corporation which is necessary to execute the powers expressly or impliedly conferred on the national government by the Constitution. In other words, Congress "may create corporations as appropriate means of executing the powers of government; as, for instance, a bank for the purpose of carrying on the fiscal operations of the United States, or a railroad corporation for the purpose of promoting commerce among the States." [3]

> Corporations organized and existing under the law for the District of Columbia "are not different from those organized in one of the States of the Union." (Ex parte Flesher, 81 Calif. A. 128, 252 P. 1057)

State Powers. In the absence of restrictions imposed by the Federal Constitution or state constitutions, state legislatures have unlimited powers to create corporations. The constitutions of most states, however, contain provisions restricting the powers of the legislatures in respect to the creation of corporations. Legislatures are almost universally prohibited from creating a corporation by special act and are required to provide for the creation of corporations under general incorporating laws. A special act is one that creates a particular corporation. A general law is one authorizing the creation of corporations by general patterns in favor of

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[3] *Luxton* v. *North River Bridge Co.*, 153 U. S. 525, 38 L. Ed. 808.

persons who may comply with its terms. A special act, on the other hand, creates corporations by an individual pattern.

Classification. Corporations may be classified in several ways: (1) in terms of membership, as corporations aggregate and corporations sole; (2) in terms of purpose, as eleemosynary and civil corporations; (3) in terms of interest served, as public, private, and quasi-public corporations, and (4) in terms of form of proprietorship, as stock and nonstock corporations.

Aggregate and Sole. A corporation aggregate is one which has more than one member. Even though one person purchases the interests of the other members in a stock corporation, it remains a corporation aggregate because the shares may be redistributed.

A corporation sole is one which is composed of a single member only and his successors. For example, the King and Queen of England, and certain parsons and bishops are corporations sole under the English law.[4] There are few instances of corporations of this kind in the United States.

Eleemosynary and Civil. An eleemosynary corporation is one which is organized for a charitable or benevolent purpose. Hospitals and universities come within this class.[5]

A civil corporation is one organized for purposes other than charitable or benevolent purposes.

Public, Private, and Quasi-Public. A public corporation is one established for governmental purposes and the administration of public affairs. Illustrations of this type of corporations are banks, hospitals, and colleges established and entirely supported by the state for the public.[6] Some public bodies, such as counties and school districts, having some corporate powers, are known as *quasi corporations.*

A private corporation is one established for private interests. This class includes those created for charitable and benevolent purposes, as well as those established for purposes of finance, industry, and commerce.

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[4] *Powlet* v. *Clark,* 9 Cranch (U. S.) 292, 3 L. Ed. 735.
[5] *Bd. of Ed. of State of Ill.* v. *Greenbaum,* 39 Ill. 609.
[6] *State* v. *Knowles,* 16 Fla. 577.

A quasi-public corporation, sometimes called a *public service corporation*, is a private corporation engaged in services upon which the public is particularly dependent. Such corporations are usually given special franchises and powers, such as eminent domain. Examples of this class of corporations are those conducting canals, toll bridges, or railroads.[7]

Stock and Nonstock. A stock corporation is one having its capital stock divided into shares, the rights and liabilities of the members being determined by ownership of such shares. This is the type of corporation utilized by business and is the one of most interest to a student of business.

A nonstock corporation is one in which the membership with attending rights and liabilities is acquired by agreement. Lodges and other fraternal organizations are common illustrations of this type of corporation.

Foreign Corporations. A corporation is a citizen of the state creating it, but it is not a citizen within the meaning of the constitutional provision which prohibits discrimination against citizens of another state. It may, however, act in other states unless prohibited. "By the law of comity, the existence of a corporation in the state where it is created and resides is recognized in foreign states, like a natural person, and it may make any contract or do any act in a foreign state, within its charter powers, which is not prohibited by the foreign state." [8]

A state may exclude entirely or restrict and regulate foreign corporations, except when in so doing it violates the Federal Constitution or the state constitution. If a state admits a foreign corporation, however, it cannot deny the corporation equal protection of the laws or deprive the corporation of its property without due process of law, since a corporation is a person within the meaning of the Fourteenth Amendment, which says: "Nor shall any state deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

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[7] *State* v. *Spokane St. Ry. Co.*, 19 Wash. 518, 53 P. 719.
[8] *Clark* v. *Memphis St. Ry. Co.*, 123 Tenn. 282, 160 S. W. 751.

Some states require foreign corporations to become domesticated, that is, to take out a charter, in order to engage in certain businesses, such as the intrastate express business. (Railway Express Agency v. Commonwealth of Virginia, 153 Va. 498, 150 S. E. 419)

A state cannot exclude corporations created by Congress or corporations transacting business that falls under the exclusive control of Congress, such as interstate carriers of goods. "A corporation of one state, authorized by its charter to engage in lawful commerce among the states, may not be prevented by another state from coming into its limits for all the legitimate purposes of such commerce. It may go into the state without obtaining a license from it for the purposes of its interstate business, and without liability to taxation there on account of such business." [9]

Regulation. All states have adopted regulations, varying in nature, which govern the admission of foreign corporations. These regulations typically provide that foreign corporations shall meet certain requirements, such as the payment of fees, the filing of articles of incorporation, and the appointment of resident agents. "The purpose of these statutes requiring foreign corporations to file certified copies of their charters, and to constitute and appoint an agent who shall reside in the state at the principal place of business of the corporation, is to protect parties dealing with them from being imposed upon, and to provide means of obtaining service upon them in the courts of the state." [10]

A state may require all or certain foreign corporations, such as guaranty companies executing official bonds, to make a deposit in trust "for the protection of, and for the exclusive benefit of, its citizens as against a nonresident creditor." (Fidelity & Deposit Co. of Maryland v. Goodwin, 231 A. 44, 163 S. 341)

The state may, of course, eject a foreign corporation which fails or refuses to comply with the requirements applicable to such a corporation. In some states statutes prescribe specific penalties. They may provide that fines shall be imposed upon the corporation or its agents, that the agents shall

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[9] *Western Union Tel. Co.* v. *Kansas*, 216 U. S. 165, 54 L. Ed. 355.
[10] *Dearborn Foundry Co.* v. *Augustine*, 5 Wash. 67, 31 P. 327.

be imprisoned, that the contracts of the corporation shall be void, or that the stockholders or agents shall be liable for the debts incurred. When a statute does not control, courts are in conflict as to the rights of the corporation on its contracts which it makes while delinquent as to admission requirements.

QUESTIONS

1. "The corporation is the only form of business unit suitable for the establishment and conduct of the great enterprises of modern business." What is meant by this statement?

2. Cain and Burdsall are discussing various forms of business units. The former contends that the most important characteristic of a corporation is that the management of the business is not in the hands of all of its members. Do you agree?

3. Congress created a corporation for the purpose of engaging in interstate commerce. It is contended that Congress had no power to create this corporation. Do you agree?

4. Lodge contends that all corporations are formed by special acts. Bunn denies this but maintains that they should be. Do you agree with either Lodge or Bunn?

5. One member of a stock corporation purchases the interest of all the other members. A question arises as to whether the organization is a corporation sole. Carr contends that it is a corporation aggregate. Do you agree?

6. A corporation is formed by a group of persons to conduct a streetcar system in a given city. The corporation contends that the organization is a quasi corporation. Is the contention sound?

7. A corporation organized under the laws of Maryland is prohibited from acting in Kentucky until it has paid a specified fee. The company contends that this requirement is a violation of Article IV, Section 2, Paragraph 1, of the Constitution of the United States, which provides: "The citizens of every state shall be entitled to all privileges and immunities of citizens in the several states." Is the contention sound?

8. A statute of a state establishes rates for the transportation of goods by railroads, that will not permit the carriers to earn a reasonable return on their property. The corporations protest that the act violates the Fourteenth Amendment, which declares that no state shall deprive any person of property without due process of law nor deny to any person within its jurisdiction the equal protection of the laws. The state contends that a corporation is not a person within the meaning of this provision. Do you agree?

9. Cochran contends that the principal object of state regulations affecting foreign corporations is to protect the citizens of the states against competition. Do you agree?

Part II—Creation

Promoters. One who, alone or in collaboration with others, undertakes to perform or to secure the performance of the various steps leading to the incorporation of a business is known as a *promoter*. He stands in a fiduciary relation to the corporation upon its coming into existence and to stock subscribers, and he cannot make secret profits at their expense. Thus, if a promoter makes secret profits on a sale of land to the corporation, he must account to the corporation for them.[1] The promoter cannot be the agent of the corporation before it comes into existence. Whether he is an agent of the subscribers depends upon circumstances.

> Because a corporation has no being until organized, "promoters or incorporators attempting to act for it cannot therefore stand in the relation of an agent to a principal." (Hinkley v. Sagemiller, 191 Wis. 512, 210 N. W. 839)

The promoter, in the absence of statutory authority, cannot bind the corporation or give it rights by a pre-incorporation contract although he purports to act for it. The corporation, upon coming into existence, may expressly or impliedly become a party to such a contract by assignment or by novation. For example, when the corporation knowingly accepts the benefit of the promoter's contract, it becomes liable thereon by implication.[2]

> Stockholders may by resolution declare that the acts of the incorporators are "unanimously approved, ratified and confirmed." (Reid v. North Park & Dodd Trust Co., 110 N. J. L. 222, 164 A. 280)

The promoter is personally liable for all contracts made in behalf of the corporation before its existence, unless he is exempted by the terms of or by the circumstances surrounding the agreement. He is also liable for all torts that he commits. Although the corporation is not ordinarily liable for the torts of the promoter, it may become so by its conduct after incorporation. Thus, when a corporation, with actual or implied

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[1] *Colton Imp. Co.* v. *Richter*, 26 Misc. Rep. 26, 55 N. Y. S. 486.
[2] *Mantle* v. *Jack Waite Mining Co.*, 24 Ida. 613, 135 P. 854.

notice of fraud, assumes responsibility for the promoter's contract, it is liable for the fraud.[3]

The corporation is not liable in most states for the expenses and services of the promoter, unless it subsequently promises to pay for them or unless its charter or statute imposes liability upon it for such expenses. A few states hold the corporation liable for such items on the ground that it has accepted the benefits of necessary services.

Requisites to Creation. All states have general laws authorizing the creation of corporations by a specified number of persons who comply with the provisions of the statute. The enactment of general incorporation laws is partly explained by the exceptional growth in the number of this form of business unit, which renders it impossible for the legislature to enact special legislation in each case, and partly by the desire of states to standardize corporation laws.

> Although a corporation was organized under the general corporation law, "its legal status would be the same if it had been created by a special act of the Legislature." (State v. Penn-Beaver Oil Co. [Del.], 4 W. W. Harr. 81, 143 A. 257)

Persons who wish to incorporate under general laws must substantially comply with the requirements of the statute. These provisions usually require a certain number of petitioners who possess, beside the capacity to contract, other qualifications, such as residence or citizenship. The Uniform Business Corporation Act requires that the incorporators consist of "three or more natural persons of full age, at least two-thirds of whom are citizens of the United States or of its territories, incorporated or unincorporated, or possessions." [4]

> Laws of Florida, 1927, expressly provide that "married women are hereby declared competent to be incorporators, . . . of any corporation." (State v. Futch, 94 Fla. 52, 113 S. 670)

The petitioners must make the proper application for a charter or properly file articles of incorporation or association, as the case may be. These documents must comply with the requirements as to form and to contents. For example,

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[3] *Forber* v. *Thorpe*, 209 Mass. 570, 95 N. E. 955.
[4] §2.

ARTICLES OF ASSOCIATION

Norris, Smith and Company of Pittsburgh.

We, the undersigned, do hereby associate ourselves together for the purpose of forming a corporation under and by virtue of the laws of the state of Pennsylvania. And we do hereby adopt the following as our articles of association:

Article 1. The name of the corporation hereby formed is Norris, Smith and Company of Pittsburgh, Pennsylvania.

Article 2. The object and purpose for which this association is formed is the manufacture and sale of soft drinks and all business incidental to such manufacture and sale.

Article 3. The amount of capital stock of this corporation is $100,000 and the same is divided into 1,000 shares of $100.00 each.

Article 4. The amount of the capital stock actually paid is $60,000.

Article 5. The names of the stockholders, and their respective places of residence, and the number of shares held by each are as follows:

L. J. Norris	Pittsburgh	250
R. O. Smith	"	250
C. D. Anderson	"	100

Article 6. The office for the transaction of the business of this corporation is located at the city of Pittsburgh, county of Allegheny, state of Pennsylvania, and said corporation is to be carried on in said county of Allegheny.

Article 7. The term of existence of this corporation shall be 20 years from the date of the execution of these articles.

Article 8. The conduct and management of the business of this corporation shall be controlled by a board of three directors who shall be elected from the stockholders of this corporation on the day of the execution hereof, who shall hold their office for one year and until their successors shall be elected. And the annual election of directors shall be held on the second Wednesday of January each year thereafter during the existence of this corporation.

Article 9. There shall be elected from said board of directors a president, secretary, and treasurer, whose duties shall be designated in the by-laws and not inconsistent with the laws of the state.

IN TESTIMONY WHEREOF, We, the undersigned associating together, have hereunto set our hands and seals on the 10th day of January, A. D. 19 .

L. J. Norris
R. O. Smith
C. D. Anderson

Acknowledgment.

STATE OF PENNSYLVANIA, COUNTY OF ALLEGHENY, ss:

On the 10th day of January, A. D. 19 , before me, the undersigned, a notary public, in and for said county and state, personally appeared L. J. Norris, R. O. Smith, and C. D. Anderson, to me well known to be persons described in and who severally executed the foregoing instrument and acknowledged that they severally executed the same as their free act and deed for the uses and purposes therein set forth.

Fred M. Burke
Notary Public, Allegheny County, Pennsylvania.

ARTICLES OF ASSOCIATION

when the statute requires the application to be a single piece of material, it may be disapproved if it contains several pieces, although they be fastened together.[5] The documents must, as a general rule, contain the following information:

[5] *In re Society Principeno Montenegro Savoya*, 6 Pa. Dist. 486.

Name. The name of the proposed corporation must be given. Generally speaking, the incorporators may select any name for the corporation.[6]

Object. The object of the proposed corporation must be set forth. Sometimes the statute enumerates the purposes for which a corporation may be formed. In all cases the object must be lawful. To illustrate, persons may be forbidden to incorporate for the purpose of practicing law or medicine.[7] Some statutes also require a statement of the means to be used in the attainment of the object of the corporation.

Capital Stock. The amount of capital stock and the number and value of the shares into which it is divided must be specified.

Place of Business. The location of the principal office of the proposed corporation must be stated.

Duration. The period during which the proposed corporation is to exist (not to exceed the period provided for in the statute) must be set forth.

Directors. The number of directors or the names of the directors for the first year must be stated. Sometimes other facts in respect to such persons are required to be given.

Incorporators. The names and addresses of the subscribers or members must be given. The number of shares subscribed by each and the method of payment must be stated.

The Uniform Business Corporation Act requires that the articles of incorporation state in the English language, in addition to the foregoing information, (1) a description of the classes of shares, the number of shares in each class, and the relative rights, voting power, preferences and restrictions granted to or imposed upon each class, and (2) the amount of the paid-in capital with which the corporation will begin business.[8]

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[6] *Post*, p. 678.
[7] *State Electro-Medical Institute* v. *State*, 74 Nebr. 40, 103 N. W. 1078.
[8] §3.

The Uniform Business Corporation Act, now designated as a model act, has been adopted in Louisiana and Washington and substantially in Idaho. Many of its provisions appear in the statutes of other states. (Uniform Laws Annotated, vol. 9, pp. 71 and 72.)

The statutory provisions as to incorporation are either directory or mandatory. A failure to comply with a directory provision does not preclude the incorporators from becoming a *de jure* corporation.[9] A failure to comply substantially with a mandatory provision is fatal. Thus, if the amount of capital stock is required to be set forth, a failure to do so is fatal to incorporation.[10] It is often difficult to determine whether provisions are mandatory or merely directory. Courts, in determining the nature of these statutory provisions, do so by seeking the intent of the legislature in view of the particular statute, its terms, and purposes. Statutes generally require the incorporators to publish either notice of their intent to incorporate or the articles of association.

The Charter. After the petition for a charter or the articles of association are filed, the fees are paid, and other conditions precedent are fulfilled, the court or an administrative officer, such as the secretary of state, examines the document. If the requirements of the law have been met, a certificate of incorporation, a license, or a charter is issued and recorded, or filed, as required by the terms of the statute.[11]

In some states corporate existence does not begin until there is an organization under the charter, and in others, not until a report on the organization is made. For example, the statute may declare that the charter shall be void if the certificate of organization is not properly filed within the time prescribed.[12] The organization meeting must be held within the state creating the corporation. If it is held elsewhere, the proceedings are not valid.

"Upon the issue of the certificate of incorporation, the corporate existence shall begin." (Uniform Business Corporation Act, Sec. 5-2)

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[9] *Post*, p. 674.
[10] *Utley* v. *Union Tool Company*, 11 Gray (Mass.) 139.
[11] *Uniform Business Corporation Act*, §5.
[12] *Ragland* v. *Doolittle*, 100 Miss. 498, 56 S. 445.

The charter is more than a document creating the power of corporate existence. "It is a well-recognized principle of law that 'the charter of a corporation having a capital stock is a contract between three parties and forms the basis of three distinct contracts. First, the charter is a contract between the state and the corporation; second, it is a contract between the corporation and the stockholders; third, it is a contract between the stockholders and the state.' " [13] As it is an agreement, the charter must be accepted. Formal resolutions to that effect and notice thereof to the proper officer are not necessary, unless required by statute. Acceptance may be inferred from the conduct of the incorporators. Thus acceptance will be assumed when the incorporators organize or operate under the charter.[14] Since the charter is a contract, the legislature cannot alter the charter without the consent of the members, unless it has reserved the right to do so.

Capital and Capital Stock. Business corporations have capital and capital stock. Although sometimes used synonymously, the terms do not mean the same thing. *Capital* refers to the assets of the corporation. "It signifies the actual estate whether in money or property, which is owned by an individual or corporation. In reference to a corporation, it is the aggregate of the sum subscribed and paid in, or secured to be paid in, by the shareholders, with the addition of all gains or profits realized in the use and investment of those sums; or, if losses have been incurred, then it is the residue after deducting such losses." [15]

Capital stock, however, is the aggregate of the sum authorized by the charter or articles of incorporation to be subscribed and paid in by the members. In other words, it is the fixed total which the corporation may receive as capital to conduct its business. As indicated above, the capital may after a time be more or less than the capital stock, depending upon whether the corporation has prospered.

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[13] *Gurey* v. *St. Joe Mining Co.*, 32 Utah 497, 91 P. 369.
[14] *Bank of U. S.* v. *Dandridge*, 12 Wheat. (U. S.) 64, 6 L. Ed. 552.
[15] *People* v. *Comm. of Texas, etc.*, 23 N. Y. 192.

> "'The capital stock of a corporation may be reduced by a resolution adopted by the vote of the holders of two-thirds of the voting power of all shareholders." (Uniform Business Corporation Act, Sec. 41-1)

It was at one time held that the capital stock and other assets of a corporation constitute a trust fund for the benefit of creditors. This theory had its origin in a dictum of Mr. Justice Story: "It appears to me very clear upon general principles, as well as the legislative intention, that the capital stock of banks is to be deemed a pledge or trust fund for the payment of the debts contracted by the bank." [16] There was no justification for the doctrine, and it was denied in later cases. "Corporate property is not held in trust, in any proper sense of the term. A trust implies two estates or interests—one equitable and one legal; one person, as trustee, holds the legal title, while another, as the cestui que trust, has the beneficial interest. Absolute control and power of disposition are inconsistent with the idea of a trust. The capital of a corporation is its property. It has the whole beneficial interest in it, as well as the legal title. It may use the income and profits of it, and sell and dispose of it, the same as a natural person. It is a trustee for its creditors in the same sense and to the same extent as a natural person, but no further." [17]

Kinds of Stock. The capital stock may, in the absence of statutory restrictions, be divided into any number of classes. Each class of stock is known by a name which indicates as a rule the peculiar features and rights connected with such stock. The usual division of stock is *common stock* and *preferred stock.* Common stock is the ordinary stock. The owner "is entitled to an equal pro rata division of the profits, if there be any, but has no advantage over any other shareholder or class of shareholders of common stock." [18] Preferred stock differs from common stock in that some sort of preference is given to the holders. The nature of the preference depends upon the terms upon which the particular stock is issued. To

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[16] *Wood* v. *Dummer*, 3 Mason 308, F. Cases No. 17,944.
[17] *Hospes* v. *Northwestern Mfg. Car Co.*, 48 Minn. 174, 50 N. W. 1117.
[18] *Storrow* v. *Tex. Cons. Compress, etc., Ass'n*, 87 F. 612.

determine "in each case the special properties and qualities it possesses, resort must be had to the statute or contract under which it was issued. 'Preferred stock takes a multiplicity of forms, according to the desire and ingenuity of the stockholders and the necessities of the corporation itself.' It is a matter of contract or depends upon statute." [19] For example, the preference may pertain to voting, to the division of profits, or to the division of the assets after dissolution.[20] When dividends are preferred, they are cumulative, unless made noncumulative by the terms of the contract. If they are cumulative, all arrears must be paid before any dividends are paid to the holders of common stock.

De Facto Corporations. If the incorporators have substantially met the requirements of the statute, the corporation is known as a corporation *de jure*. If, however, they have failed to comply with some provision of the law, the state, in a direct proceeding for that purpose, may question their right to act as a corporation.[21] Until the state makes such attack, the defectively organized association continues to exist as a *de facto* corporation. As such, it enjoys all the privileges of a corporation de jure, except that it is subject to ouster by the state.

> "The rights and franchises which may have been usurped by a de facto corporation are rights and franchises of the sovereign who alone has the right to interpose." (Fiedler v. Eckfeldt, 335 Ill. 1, 166 N. E. 504)

There is a conflict in the authorities as to what constitutes a corporation de facto. Most courts say that there are four essential elements of a de facto corporation. First, there must be a valid law under which a de jure corporation might have been created. "Where there cannot lawfully be a corporation de jure, there cannot be one de facto." [22] Second, the attempt to organize must be made in good faith. For example, if the

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[19] *Scott* v. *Baltimore & Ohio R. R. Co.*, 93 Md. 475, 49 A. 327.
[20] *Hamlin* v. *Toledo, etc., R. R. Co.*, 78 F. 664.
[21] *Uniform Business Corporation Act*, §9.
[22] *Georgia So., etc., R. R. Co.* v. *Mer. Trust, etc., Co.*, 94 Ga. 306. 21 S. E. 701.

parties had no intention to fulfill the requirements of the law, a corporation de facto does not come into existence.[23] Third, the attempt to organize must result in colorable compliance with the requirements of the statute. Thus a corporation de facto cannot exist where there is a failure to perform acts which are clearly specified as conditions precedent to corporate existence.[24] What amounts to colorable compliance differs with the terms of the various statutes. It need not be substantial compliance, for that would make it de jure. Between doing absolutely nothing and substantial performance, there are many details which can be omitted without denying the claim of colorable compliance. Fourth, there must be a use of corporate powers. Although very little evidence is required in respect to this, "there must be a user of such corporate rights as could be authorized by law, and not merely such as might be exercised by individuals or unincorporated societies." [25]

Estoppel. If an association pretends to be a corporation, and is neither a corporation de jure nor a corporation de facto, the members are in most states liable as partners. Some states do not follow this rule, holding that the agent with whom one deals is alone liable on an implied warranty of authority. The majority rule is subject to one limitation: When a third person deals with the group as a corporation, he is estopped to deny its corporate existence. Thus one court says: "Where a person deals with what he supposes is a corporation, with what all parties think is a corporation, where he gives his credit to that supposed corporation, he cannot afterwards, when it turns out that it is not validly incorporated, turn around and say, 'Well, I dealt with this supposed corporation; I thought it was a corporation; I trusted it as a corporation; I sold goods to it as a corporation; but it seems that when it first attempted to become incorporated there was some defect or irregularity in its proceedings so that it did not become legally incorporated, and therefore you who are stockholders will be held personally liable.' " [26] The

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[23] *Card* v. *Moore*, 68 App. Div. 327, 74 N. Y. S. 18.
[24] *Slocum* v. *Providence Stan., etc., Co.*, 10 R. I. 112.
[25] *Elgin Nat'l Watch Co.* v. *Loveland*, 132 F. 41.
[26] *Gartside Coal Co.* v. *Maxwell*, 22 F. 197.

doctrine is also applied against the association itself and its members in favor of a third person dealing with the group.

> "One of the corporators may not deny the existence of the corporation he has caused to be brought into existence and under which he and his associates have carried on business." (Sun River Stock & Land Co. v. Montana Trust & Sav. Bank, 81 Mont. 222, 262 P. 1039)

It must be clear, however, that the third person recognizes the corporate existence. Thus, when one deals with an association in ignorance of the members' claim, although the name of the group might properly be that of a corporation, there is no estoppel.[27] The application of the doctrine is also refused if the exercise of such corporate powers is prohibited by law, or if the particular circumstances make it inequitable to invoke the doctrine. Some courts do not apply the doctrine of estoppel unless there is at least a corporation de facto.

QUESTIONS

1. A promoter, while organizing a corporation, enters into a contract in the name of the corporation to purchase ten acres of land from Kern. The corporation, upon coming into existence, refuses to accept the deed for the land and to pay the purchase price. Kern brings an action for breach of contract against the corporation. Is he entitled to judgment?

2. Wells and Roeder promoted the X-Y-Z Corporation. They gave approximately three weeks of their time and spent thirty-five hundred dollars in performing the various steps leading up to the incorporation of the business. They then claimed remuneration for their services and reimbursement for their expenditures from the corporation. Was their claim enforceable?

3. A corporation was formed by the manufacturers and sellers of refrigerators for the purpose of obtaining control over the manufacture and sale of the product and, by this means, control over supply and prices. The state brought an action to deprive the corporation of its charter. Could the action be maintained?

4. A group of incorporators who secured a charter from the state of Illinois held the organization meeting in Indiana and passed resolutions accepting the charter. It was later contended that the organization was not regularly incorporated. Do you agree?

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[27] *Owen Lumber Co.* v. *Wellman*, 10 S. Dak. 122, 72 N. W. 89.

5. A corporation is formed to engage in the manufacture of automobiles. Later the legislature authorizes the majority of the stockholders to make a change in the charter, which will permit the corporation to engage in business of a different nature. The minority stockholders contend that the alteration of the charter is unconstitutional. Do you agree?

6. "The terms capital and capital stock, although sometimes used interchangeably, do not mean the same thing." Do you agree with this statement?

7. A corporation is negotiating the sale of a large part of its assets to Hurley. Upon discovering that the corporation is insolvent, Hurley refuses to buy the property. He contends that the assets of the corporation are a trust fund for the benefit of its creditors. Is his contention sound?

8. Brandenburg is a holder of six per cent preferred stock. The corporation earns four per cent annually for three successive years. During this time no dividend is declared by the directors. After the third year the directors declare a six per cent dividend on the preferred stock and a four per cent dividend on the common stock. Brandenburg contends that the directors cannot lawfully declare this dividend on the common shares. Do you agree?

9. An action, brought to question the right of a certain organization to act as a corporation, resulted in a judgment denying the right. Creditors claimed that this judgment rendered the incorporators liable as partners. Was the contention of the creditors sound?

10. Fordham makes a shipment of goods as ordered by an association known as the American Music Company. This association, unknown to Fordham, pretends to be a corporation. It later turns out that the association is neither a corporation de jure nor a corporation de facto. Fordham brings an action against the members as partners. The defense is that Fordham is estopped to deny the corporate existence of the corporation. Is Fordham entitled to judgment?

Part III—Corporate Powers

Common-Law Powers. A corporation has certain powers which are incidental to corporate existence. They are frequently referred to as common-law powers. These powers attach to a corporation at its creation, unless there are express restrictions denying one or more of them.[1]

Perpetual Succession. The power to continue as a unit regardless of a change in membership is known as perpetual succession. The term does not necessarily mean indefinite duration, but rather continuous succession during a given period. If no period is fixed for its duration, the corporation will exist indefinitely, unless legally dissolved. The period of duration is frequently limited by constitutional or statutory provision. When the period is limited by charter or statute, the corporation may in many states extend the period by meeting specified requirements of the statute.

> A corporation was extended an additional thirty years upon payment of a franchise fee to be a corporation and a franchise fee for doing business in the state as a corporation. (Cobbs & Mitchell v. Corporation Tax Appeal Board, 252 Mich. 478, 233 N. W. 386)

Corporate Name. Obviously enough, a corporation, to function as such and to carry on its various activities, must have a name. "A corporation is a body politic consisting of material bodies which, joined together, must have a name to do things which concern the corporation, or else it is no corporation.[2] A corporation may, as a general rule, select any name for its purpose. It may not, however, select a name, such as a geographical or descriptive name, which all may lawfully use, or some word to the exclusive use of which another is entitled. For example, it was held that a corporation operating under the name of Mount Hope Cemetery Association could preclude a rival corporation from using New Mount Hope Cemetery Association as its name.[3] Even though the practice of imi-

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[1] *Uniform Business Corporation Act*, §11.
[2] *River Tone* v. *Ash*, 10 B. & C. 349.
[3] *Mount Hope C. Ass'n* v. *New Mount Hope C. Ass'n*, 246 Ill. 416, 92 N. E. 912.

tating another's name is not prohibited by statute, courts accomplish the same result under the common-law principles governing unfair competition. Some statutes prescribe certain requirements in respect to the names of corporations. To illustrate, a statute may require that the last word of the name be "Corporation" or that the word "Limited" or "Incorporated" be used in conjunction with the name selected.[4]

> "Bankelectric" as part of a corporate name violated a statute which provides that no corporation shall be organized "with the word 'bank,' among others therein mentioned, as part of its name, except a moneyed corporation." (People v. Flynn, 231 App. Div. 763, 246 N. Y. S. 125)

The Uniform Business Corporation Act prohibits the use of the same or a deceptively similar name of a corporation authorized to do business in the United States, unless such corporation gives written consent or is about to change its name or to go out of business. It also requires that the name end with "Inc." or include the word "Incorporated" or "Corporation," or include the word "Company" if not preceded by "and" or "&." [5]

Acquisition of Property. Although the power to acquire and hold property is usually given in the charter, a corporation always has the implied power to acquire and hold such property as is reasonably necessary in carrying out its express powers. "The power of taking and holding real estate —as well as personal property—is generally laid down as one of the powers incident to every corporation, unless there be an express prohibition, or such power be clearly repugnant to the purposes of its creation, or forbidden by some positive law." [6] In some states the power of a corporation to hold property is restricted as to the method of acquiring it or is limited as to the quantity or value of the property to be held.

> Restrictions on holding real estate by corporations are in some constitutions. (Ky. 192, La. 265, Mich. XII-5, Mo. XII-7, Okla. XXII-2, Pa. XVI-6, and S. D. XVII-7)

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[4] *Comm.* v. *American Snuff Co.*, 125 Ky. 350, 101 S. W. 364.
[5] §4.
[6] *State University* v. *Detroit Young Men's Soc.*, 12 Mich. 138.

Corporate Seal. Although the power to have a seal is frequently conferred by an express provision of law, this is not necessary, as "it is an inseparable incident of every corporation that it may have a common seal, and make, alter, and renew the same at pleasure." [7] A corporate seal was indispensable under early law which required its use in the making of all but minor contracts. At present, however, a corporation need not use a seal in the transaction of business, unless it is required by statute to use a seal or unless a natural person in transacting the same business would be required to use a seal. To illustrate, a corporation must use its seal when a sealed instrument is required for the conveyance of land.[8]

> A corporation need not use its common seal in executing a contract under seal, but may use the letters "L. S.," surrounded by a ring. (Feder v. Forrest Hill Apartments, 100 N. J. Eq. 455, 136 A. 297)

By-Laws. Every corporation has the inherent power to make by-laws, although the power is frequently granted by express law. "The office of a by-law is to regulate the conduct and define the duties of the members towards the corporation and between themselves." [9] Reasonable by-laws, which are not contrary to public policy or inconsistent with the general law of the land, are binding upon all stockholders regardless of their knowledge or consent. They do not, however, impose liabilities or confer rights on third persons, unless such persons impliedly or expressly assent to them. For example, an extension of a period of redemption by a general agent who, unknown to the mortgagee, did not possess such authority because of a limitation in the by-laws, is binding upon the corporation.[10]

Express Powers. In addition to the common-law powers, the charter especially confers certain powers on a corporation. Unless prohibited by the state constitution or by the Federal

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[7] *Ransom* v. *Stonington Sav. Bank*, 13 N. J. Eq. 212.
[8] *Richardson* v. *Scott River Water, etc., Co.*, 22 Calif. 150.
[9] *Flint* v. *Pierce*, 99 Mass. 68.
[10] *Union Mutual Life Ins. Co.* v. *White*, 106 Ill. 67.

Constitution, the legislature of a state may freely grant power to corporations.

It is well settled that a corporation can exercise only such powers as are expressly or impliedly conferred upon it by its charter. Thus one court says: "A corporation has the power to do only such business as it is authorized to do by its charter and no other. A corporation cannot usurp functions not granted to it, nor stretch its lawful franchises beyond the limits of their reasonable intendment. It cannot engage in matters foreign to the objects for which it was incorporated. Its main business must be confined to those operations which appertain to the general purposes for which it was organized and which are defined in its charter. It is not clothed with all the capacities of a natural person or of an ordinary partnership. It is restricted to such as are conferred by its grant for the right to exist. Its lawful business may not vary materially from the objects for which it was created." [11]

> One who takes a note on which a corporation is an accommodation indorser, is "charged with notice of the powers of the corporation as granted in its charter." (Stephens v. Brackin, 16 La. A. 272, 134 S. 326)

The scope of the express powers of a corporation depends upon their construction. If the terms are ambiguous, the rule of strict construction is applied as against the corporation in favor of the public. The rule is particularly applied when the grant is exclusive, when it provides for exemptions, or when it gives special favors or immunities. "If the powers conferred are against the common right, and trench in any way upon the privileges of other citizens, they are, in cases of doubt, to be construed strictly, but not so as to impair or defeat the objects of the incorporation." [12]

Implied Powers. The powers given to a corporation by its charter include not only the powers expressed therein but also such powers as are reasonably necessary to the corporation in the carrying out of its express powers. Powers of the latter type are known as implied powers. "Whether or not the implied powers of a corporation authorize it to engage

[11] *Teele* v. *Rockport Granite Co.*, 224 Mass. 20, 112 N. E. 497.
[12] *Downing* v. *Mt. Washington Co.*, 40 N. H. 230.

in an undertaking or enterprise not directly related to the declared objects of the charter depends not upon the question whether the particular enterprise would have a tendency to increase the legitimate corporate business, but upon the question whether the exercise of such authority, in view of the circumstances, is reasonably necessary to the proper prosecution of that business." [13] It is impossible to consider all the powers which may be reasonably necessary to carry out particular enterprises. The following implied powers are typical.

Borrowing Money. It is universally agreed that corporations have the implied power to borrow money in carrying out its authorized business purposes. For example, a fire insurance company may borrow money to pay losses.[14]

Execution of Negotiable Instruments. The power to issue or indorse negotiable instruments, or to accept bills of exchange, is implied when the corporation has the power to borrow money, and when such means are appropriately and ordinarily used to further the object of its creation. To illustrate, a railroad company may issue a promissory note in payment of a debt incurred in the construction of its road.[15] In England the right to issue negotiable instruments is limited to trading corporations.

Bonds. A corporation having the power to borrow money has also the implied power to issue various types of bonds, which are merely devices for borrowing money. "A bond is merely an obligation under seal. A corporation having the capacity to sue and be sued, the right to make contracts, under which it may incur debts, and the right to make and use a common seal, a contract under seal is not only within the scope of its powers, but was originally the usual and peculiarly appropriate form of agreement." [16]

Transferring Property. A corporation having power to incur debts may mortgage or pledge its property as security for its debts. This rule does not apply to franchises of pub-

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[13] *Fifth Ave. Coach Co.* v. *New York*, 58 Misc. Rep. 401, 111 N. Y. S. 759.
[14] *Orr* v. *Meiser Co. Mut. Fire Ins. Co.*, 114 Pa. 387, 6 A. 696.
[15] *Union Bank* v. *Jacobs*, 6 Humph. (Tenn.) 515.
[16] *Comm.* v. *Smith*, 10 Allen (Mass.) 448.

lic service companies, such as street railways and gas and electric companies. The corporate property may be leased, assigned for the benefit of creditors, or sold. A solvent corporation in some states may not, however, transfer all of its property except with the unanimous consent of stockholders.

Acquisition of Its Own Stock. In many states a corporation may purchase its own stock, unless it works a hardship on the creditors or stockholders. To illustrate, a purchase of its own stock by a corporation is invalid when the corporation is insolvent.[17] In a few states corporations are denied implied power to purchase their own stock, but they are permitted to receive it as a gift, in payment of a debt, or for the security of a debt.

Powers Not Implied. In general, powers will not be implied when they have only a slight or remote relation to the execution of the express powers of the corporation. The following are typical of the powers which are not implied:

Consolidation. A corporation has no implied power to consolidate with another corporation. This requires the consent of the state, as a consolidation is virtually tantamount to the creation of a new corporation. Consolidation also requires the express or implied consent of all the stockholders, unless the privilege of consolidating is a part of the corporation's contract with the stockholders.

Entering Partnership. A corporation, generally speaking, has no implied power to form a partnership with a partnership, an individual, or another corporation. "The agency of each partner for the partnership is inconsistent with the management of the corporation by its stockholders through directors and officers chosen only by themselves." [18]

Lending Credit. Ordinarily a corporation has no implied power to lend its credit. It cannot as a general rule enter into a contract of suretyship or guaranty for another corporation or person. Likewise, a corporation has no implied power

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[17] *Copper Belle Mining Co.* v. *Costello*, 11 Ariz. 334, 95 P. 94.
[18] *Fechteler* v. *Palmer*, 133 F. 462.

to become an accommodation maker of a note, drawer or acceptor of a bill, or indorser of either a bill or a note. In lending its credit in these various ways, a corporation would be performing an act outside the scope of its business.

Holding Other Stock. Although some courts permit a corporation without express authority to acquire and hold stock in another corporation, a majority deny the power on several grounds. One strong objection is the possibility of monopolies. Another objection is that it alters the purposes for which stockholders invested their capital, or for which authority was given to the corporation. "If a corporation can purchase any portion of the capital stock of another corporation, it can purchase the whole and invest all its funds in that way, and thus be enabled to engage exclusively in a business entirely foreign to the purposes for which it was created. A banking corporation could become a manufacturing corporation, and a manufacturing corporation could become a banking corporation." [19]

The Uniform Business Corporation Act permits a corporation to lend its credit to other corporations and to hold stock in another corporation "to accomplish its purpose as stated in the articles of incorporation." [20] It is felt that such powers, under the express limitations that have been granted by many state statutes, will not be prejudicial to the interest of stock holders.

Ultra Vires Acts. When a corporation performs acts which are beyond the scope of its authorized powers, such acts are said to be *ultra vires*. These acts, however, should not be confused with illegal acts. "The words *ultra vires* and *illegality* represent totally different and distinct ideas. It is true that a contract may have both these defects, but it may have one without the other. For example, a bank has no authority to engage, and usually does not engage, in benevolent enterprises. A subscription, made by authority of the board of directors and under the corporate seal, for the building of a church or a college or an almshouse would be clearly ultra vires, but it

[19] *Franklin Co.* v. *Lewiston Inst. for Sav.*, 68 Me. 43.
[20] §12.

would not be illegal. . . . Such dealings are outside of the charter; but, so far from being illegal or wrong, they are in themselves benevolent and praiseworthy." [21]

> "The phrase 'ultra vires' unfortunately has been used to designate, not only acts beyond the express and implied powers of a corporation, but also acts which are contrary to public policy or contrary to some statute expressly prohibiting them. The latter class of acts are now termed 'illegal,' and the term 'ultra vires' is confined to the former class." (In re Grand Union Co., 219 F. 353)

A stockholder is entitled to enjoin a threatened act which is clearly beyond the powers authorized by the charter. If the corporation actually engages in an ultra vires transaction of a serious nature, the state in a proper proceeding may revoke the charter. Courts, in determining the effect of ultra vires acts as between the corporation and the person with whom it deals, are in conflict. Some courts hold that no action can be maintained upon an ultra vires contract. The reasons assigned are (1) "the interests of the public that the corporation shall not transcend the powers granted; (2) the interest of the stockholders that the capital shall not be subjected to the risk of enterprises not contemplated by the charter, and therefore not authorized by the stockholders in subscribing for the stock; (3) the obligation of every one entering into a contract with a corporation to take notice of the legal limits of its powers." [22] In some of these jurisdictions, however, courts make exceptions. A majority of courts do not permit either party to invoke the doctrine of ultra vires when it would cause inequitable results.

> "The doctrine of ultra vires, whether invoked for or against a corporation, is not favored in the law. It should never be applied where it will defeat the ends of justice." (Palm Beach Estates v. Croker, 106 Fla. 617, 143 S. 792)

In practically all states, courts refuse to assist either party when the contract is either executory or fully performed on both sides. On the other hand, most courts hold that a contract

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[21] *Bissel* v. *Michigan So., etc., R. R. Co.*, 22 N. Y. 258.
[22] *Pittsburgh, C. & St. L. Ry. Co.* v. *Keokuk & A. Bridge Co.*, 131 U. S. 371. 33 L. Ed. 157.

is binding if the person dealing with the corporation does not have notice that the act is ultra vires. For example, when a negotiable instrument does not disclose that the corporation is an unauthorized accommodation maker, a holder in due course can enforce the obligation.[23] When the contract has been performed on one side, courts in most states allow the party who has performed to recover the reasonable value of his performance. In the event that a corporation without authority receives or transfers real or personal property, the transaction is not voidable at the election of the parties, although the state may discipline the corporation for its ultra vires act. It is said that "this rule, while recognizing the authority of the government to which the corporation is amenable, has the salutary effect of assuring the security of titles and avoiding the injurious consequences which would otherwise result." [24]

QUESTIONS

1. A statute in a given state permits incorporations for a period of only fifty years. It provides, however, for a renewal of a charter at the end of the period, provided certain requirements are met. Does a corporation organized under this statute possess the power of perpetual succession?

2. A corporation organized for the purpose of manufacturing and selling watches adopted the name of The Denver Watch Company. Sometime later another corporation was incorporated for the purpose of manufacturing and selling watches; it also adopted as its name The Denver Watch Company. The first corporation brought suit in equity to enjoin the latter company from using the name. Was it entitled to an injunction?

3. A company was incorporated for the purpose of engaging in the printing and engraving business. The charter of the corporation did not expressly authorize the acquisition and holding of real property. The company having decided to expand its business and enlarge its equipment wished to purchase a piece of land and construct a building on it suitable for its purpose. Did the corporation possess the power to do this?

4. A corporation was formed for the purpose of conducting a hospital. The charter contained a provision exempting the real estate of the

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[23] *McIntire* v. *Preston*, 5 Gilman (Ill.) 48.

[24] *Kerfoot* v. *Farmer's & Merchant's Bank*, 218 U. S. 281, 54 L. Ed. 1042.

corporation from taxation. Sometime later an assessment for pavement was made upon the real property of the corporation. The company contended that under the terms of its charter its real estate was exempt from assessment for such improvements. Do you agree?

5. An incorporated building association borrowed ten thousand dollars on negotiable promissory notes for the purpose of lending the money to others. The charter contained no express authority for issuing negotiable instruments. The state contended that the corporation had acted beyond its powers. The corporation claimed that it had the implied power to execute these notes. Do you agree with the state or the corporation?

6. A corporation enters into an agreement to purchase five thousand shares of its own stock for the purpose of either retiring or holding it. The seller refuses to perform on the ground that a corporation, in the absence of express authority, cannot purchase its own stock. The corporation brings an action for breach of contract. Is it entitled to judgment?

7. The Sun Gas-Light Company decided to expand its business. With this in view it entered into negotiation with the Better Light and Heat Producing Company for a consolidation of the two companies. Some of the stockholders of the Sun Gas-Light Company objected to the consolidation on the ground that it was not within the powers of the corporation. The company contended that it had an implied power to consolidate. Was the objection of the stockholders valid?

8. A hotel company, operating several hotels along the line of the X Railway Company, issued bonds for fifty thousand dollars. In order that these bonds could be readily marketed, the railroad company entered into a contract by which it guaranteed interest on the bonds. Was this contract within the powers of the railroad company?

9. An association is incorporated for the purpose of manufacturing and selling threshing machines and other agricultural implements. Later the corporation purchases stock in several banks. A stockholder contends that these transactions are beyond the powers of the company. Do you agree?

10. A corporation engaged in manufacturing sewing machines enters into an agreement to execute a promissory note as an accommodation maker for Healy. The company refuses to issue the note at the agreed time, and Healy brings an action against it for damages arising out of a breach of contract. Is he entitled to judgment?

11. A corporation is formed for the purpose of selling magazines and newspapers. It purchases a five-hundred-acre fruit farm from Mendel. Later Mendel offers to return the money and demands that the land be reconveyed to him. Upon the company's refusal to comply with his demand, Mendel brings an action to recover the property. Is he entitled to judgment?

Part IV—Membership

Stockholders. Members of a stock corporation are known as *stockholders* or *shareholders*. The basis of membership is ownership of shares of stock. The capital stock of a corporation is divided into shares which ordinarily represent a certain amount contributed or promised to the total fund. A share of stock is personal property in the nature of a chose in action. It does not give the stockholder ownership in the assets of the corporation. "A share of corporate stock is the right which the stockholder has to participate, according to the number of shares, in the surplus profits of the corporation on a division, and in the assets or capital stock remaining after payment of its debts on its dissolution or on the termination of its active business and operation." [1]

> "Unissued stock 'merely represents the right to admit new stockholders, and has no value in itself.'" (Chicago, M., St. P. & R. R. Co. v. Harmon, 89 Mont. 1, 295 P. 762)

Certificate of Stock. The stockholder's proprietorship in the corporation is usually evidenced by an instrument known as a *certificate of stock*. This document is executed by the corporation acknowledging the interest of the party to whom it is issued and is signed by the appropriate corporate officer.

The Uniform Business Corporation Act requires that the certificate state: (1) The state of incorporation, (2) the name of the registered holder, (3) the number and the class of shares represented, (4) the value of each share, (5) the number of such shares authorized to be issued, and (6), if there is more than one class of shares, a summary of the rights or restrictions of each class.[2]

Acquiring Shares. Ownership of shares of stock may be acquired in one of two general ways, by subscription or by transfer. It may be acquired by subscription either before or after the corporation is organized. In the case of transfer it may be acquired from the corporation itself or from a stockholder.[3]

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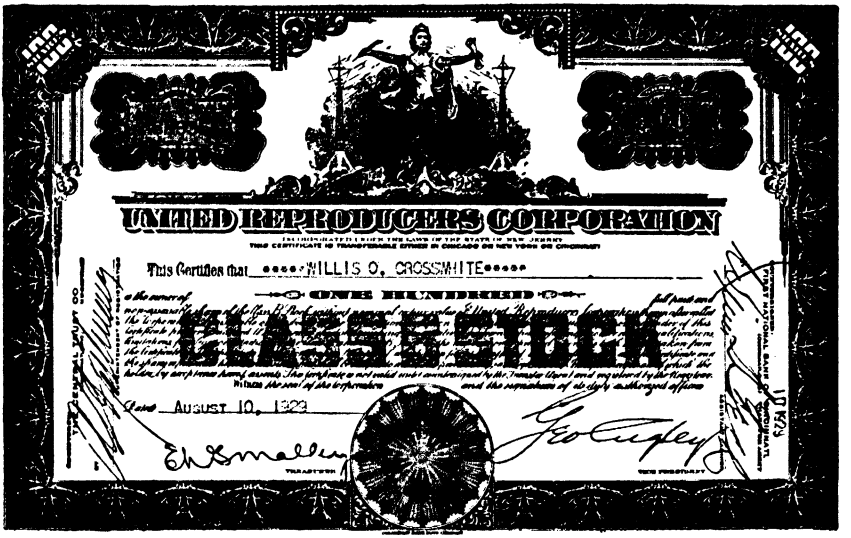
[1] *U. S. Radiator Corp.* v. *State*, 208 N. Y. 144, 101 N. E. 783.
[2] §14.
[3] *Uniform Business Corporation Act*, §15.

Subscriptions. A subscription is an agreement to take and pay for a specified number of shares of stock. It is, in



STOCK CERTIFICATE

other words, a contract to invest a certain amount of money in a given corporate enterprise. As it is not a sale, the transaction does not come within the provisions of the seventeenth section of the Statute of Frauds, which have been considered in an earlier section.[4] Subscriptions for stock may in general be made by any person who is competent to contract. No particular form is required at common law, but statutes frequently prescribe certain formalities. When statutory requirements govern, they must be complied with in order to make a valid subscription. Examples of statutory requirements are the requirements that subscriptions be in writing, that they be accompanied by cash payments, and that the original subscribers sign the articles of association.[5]

Before Organization. Most subscriptions are made prior to incorporation. A few states hold that such subscriptions automatically become binding contracts when the organization of

[4] *Ante*, p. 557.
[5] *Carlisle* v. *Saginaw Valley & St. L. R. R. Co.*, 27 Mich. 315.

the corporation is complete. In most states, however, courts hold that the corporation must expressly or impliedly accept a subscription before the subscriber is bound. Until this is done, the subscription is regarded as an offer to the corporation to be formed. It follows that the usual rules governing offers apply. For example, the subscription may lapse by death or insanity, or it may be withdrawn by the subscriber at any time before it is accepted.[6]

> A contract to buy "when issued stock" was regarded "not a subscription to stock to be issued," but "as an agreement to buy a definite stock interest in existing corporation," provided the stock was issued. (Clucas v. Bank of Montclair, 110 N. J. L. 394, 166 A. 311)

The Uniform Business Corporation Act requires subscriptions for shares of a corporation to be formed to be in writing. It declares that, unless otherwise provided in writing, the subscription shall be irrevocable for a period of one year, except that as in the case of any contract there may be a rescission thereof upon proper grounds. The subscription may be revoked after the lapse of a period of one year unless prior to such revocation a certificate of incorporation has been issued to the subscriber.[7]

After Organization. Subscriptions are sometimes made after incorporation. In this event the transaction is like any other contract with the corporation. The offer of the subscription may come from the subscriber or from the corporation, but in either case there must be an acceptance. Upon an acceptance the subscriber immediately becomes a shareholder with all rights, privileges, and liabilities.

> If a contract to take stock is interpreted as a "stock subscription," and not as an "executory sale," the corporation need not tender stock as a condition to recovery of promised amount, because "subscribers become stockholders immediately upon subscribing." (Boroseptic Chemical Co. v. Nelson, 53 S. D. 546, 221 N. W. 264)

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[6] *Patty* v. *Hillsboro Roller Mill Co.*, 4 Tex. Civ. A. 224, 23 S. W. 336.

[7] §6.

Conditions Precedent. The subscription may provide that it shall be dependent upon the performance of some act or the happening of some contingency. Such a subscription, if made after incorporation, is valid unless it is contrary to some charter or statutory provisions. The subscriber becomes a stockholder only upon the fulfillment of the condition. A conditional subscription made prior to incorporation is generally held void on the ground that it is fraudulent as to unqualified subscribers and creditors. One court says: "Any other rule would lead to the procurement from the Commonwealth of valuable charters without any absolute capital for their support, and thus give rise to a system of speculation and fraud which would be intolerable." [8] Some courts, however, hold that the condition only is void, and that the subscription is valid.

Transfer of Stock. Generally speaking, a stockholder may transfer his shares to any competent person, in the absence of restrictions imposed by statute, charter, by-laws, or agreement. Ordinarily the charter or by-laws provide that the directors shall have the power to prescribe the manner in which shares shall be transferable on the books of the corporation. Such restrictions, however, must not amount to unreasonable restraint. The purpose of these regulations is to keep the corporation and the public informed as to stock ownership. "The power can only go to the extent of prescribing conditions essential to the protection of the association against fraudulent transfers, or such as may be designed to evade the just responsibility of the stockholder. It is to be exercised reasonably. Under the pretense of prescribing the manner of the transfer, the association cannot clog the transfer with useless restrictions, or make it dependent upon the consent of the directors or other stockholders." [9]

> In upholding validity of a charter provision requiring holder to offer stock to the corporation before sale to a stranger, the court stated that reasonable restraints "are not offensive to the general policy of the law which favors the freedom of alienation." (Lawson v. Household Finance Corporation, 17 Del. Ch. 343, 147 A. 132)

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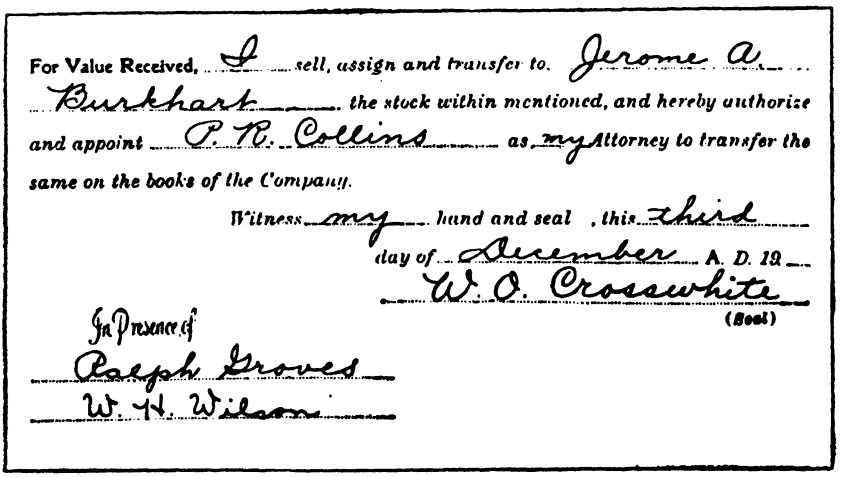
[8] *Caley* v. *Phil., etc., R. R. Co.*, 80 Pa. 363.
[9] *Johnson* v. *Laflin*, 103 U. S. 800. 26 L. Ed. 532.

Method of Transfer. At common law a transfer of shares may be made by delivery of the certificate with an assignment or by delivery alone, as in the case of a gift. As a general rule, a form of assignment is printed on the certificate. When it is required that a transfer be made on the books of the corporation, some courts hold that until such a transfer is made the transferee has only an equitable title. Other courts hold that the legal as well as the equitable title passes to the transferee, subject to the rights of the corporation. The latter view is adopted by the Uniform Stock Transfer Act.[10] In all states, until there is a transfer on the books in accordance with a lawful requirement, the corporation is entitled to treat as the owner the person whose name is on the books. The Uniform Stock Transfer Act states: "Nothing in this act shall be construed as forbidding the corporation: (a) To recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such


For Value Received, I sell, assign and transfer to Jerome A. Burkhart the stock within mentioned, and hereby authorize and appoint P. R. Collins as my Attorney to transfer the same on the books of the Company.

Witness my hand and seal, this third day of December A. D. 19 12

W. O. Crosswhite (Seal)

In Presence of

Ralph Groves

W. H. Wilson

TRANSFER OF STOCK

owner; or (b) to hold liable for calls and assessments a person registered on its books as the owner of shares." [11]

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[10] §1.
[11] §3.

The Uniform Stock Transfer Act has been adopted in Ala., Alaska, Ariz., Ark., Calif., Colo., Conn., Del., District of Columbia, Fla., Ga., Ida., Ill., Ind., Ky., La., Me., Md., Mass., Mich., Minn., Miss., Mo., Mont., Nebr., Nev., N. H., N. J., N. M., N. Y., N. C., N. D., Ohio, Okla., Oreg., Pa., R. I., S. C., S. D., Tenn., Tex., Utah, Va., Wash., W. Va., Wis., and Wyo. (Uniform Laws Annotated, vol. 6, Cumulative Annual Pocket Part for use during 1947)

Unauthorized Transfer. Under the common law the transferee secures no greater rights than the transferor possessed, because certificates of stock are nonnegotiable choses in action. The Uniform Stock Transfer Act, however, appears to have given certificates of stock substantially the same degree of negotiability as possessed by negotiable instruments.[12]

Lien of Corporation. A corporation under the common law has no lien on its stock for debts due from the stockholders. Statutory or charter provisions may create a lien in favor of the corporation, or authorize the creation of a lien by provisions in the by-laws.[13] In either event a transferee, with or without notice, takes stock subject to existing liens. The Uniform Stock Transfer Act provides that "there shall be no lien in favor of a corporation upon the shares represented by a certificate issued by such corporation, and there shall be no restriction upon the transfer of shares so represented by virtue of any by-law of such corporation, or otherwise, unless the right of the corporation to such lien or the restriction is stated upon the certificate." [14]

Blue Sky Laws. The term *blue sky laws* refers to the statutory enactments regulating the sale of securities, including the stock of corporations. The purpose of such legislation is to protect persons against investments in fraudulent secu-

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[12] §§5 and 7.

[13] The Uniform Business Corporation Act gives the corporation a lien for unpaid subscriptions (§22). This lien presents no problem in respect to the rights of third persons, however, because another provision prohibits the issuance of a certificate of stock until the shares represented thereby have been paid for in full (§16). A violation of this section does not render the shares invalid (§19), and one who takes without knowledge that the shares have not been paid for in full is not liable to the corporation for such payment (§20).

[14] §15.

rities. The first law of this nature was enacted by the Kansas legislature in 1911, after the bank commissioner had discovered that the citizens of that state were annually being swindled out of four to six million dollars by those engaged in the sale of "highly speculative" securities.[15]

> Referring to its "Blue Sky Law," a court said: "The plain and evident purpose of this statute is to prevent what is called 'fly by night concerns' or 'get rich quick schemes,' which are sold to unsuspecting, ofttimes ignorant and inexperienced, individuals." (Brock v. Hines, 97 Okla. 147, 223 P. 654)

The various securities laws differ in many details. In general they forbid the marketing of certain issues, or they furnish some guides for the protection of investors. The Illinois Securities Law, enacted in 1919, is one of the best of such laws. It provides for a classification of securities on the basis of their speculative or nonspeculative character. Class A includes securities of well-known quality, such as those issued by governments and banks. Class B includes securities sold under conditions which preclude fraud, such as those sold at a judicial or executor's sale. The securities in Class C are based upon an established income. All other securities are in Class D. Securities in Classes C and D can be sold only after filing certain sworn statements and only with the permission of the state. Class D securities must meet greater requirements. For example, subscription blanks must have printed thereon, "These are speculative securities." [16] The penalties for failure to comply with the Illinois act vary, ranging from fines of one hundred dollars to twenty-five thousand dollars, to imprisonment of from six months to five years, or both a fine and imprisonment, depending upon the transaction and whether it is the first or second offense.

Federal Securities Act.[17] On May 27, 1933, Congress enacted legislation known as the "Securities Act of 1933." This

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[15] Securities laws are called blue sky laws from a remark made in connection with this statute, that some companies sought to "capitalize the blue sky."

[16] *Cahill's Illinois Revised Statutes*, 1929, Ch. 32, 262.

[17] *U. S. Statutes at Large 1933-34*, Vol. 48, Ch. 38.

statute declares it unlawful to make use of the mails or of any means of transportation or communication in interstate commerce (1) to sell or to offer to buy unregistered securities through the use or medium of any prospectus or otherwise, or (2) to carry or transmit any prospectus relating to any registered security unless such prospectus meets the requirements of the act. The act also makes it unlawful to carry or to cause to be carried through the mails or in interstate commerce (1) any unregistered securities for the purpose of sale or for delivery after sale, or (2) any registered securities for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of the act.[18]

> The enactment of the foregoing section of the Securities Act was a valid exercise of power by Congress. (Securities & Exchange Com'n v. Crude Oil Corp., 93 F. [2d] 844)

The act does not apply to securities issued by the government, certain banks, farmers' co-operative associations, certain common carriers, and religious organizations, or to a few other specified obligations.[19] Certain transactions, as well as certain securities, are exempted from the provisions of the statute. The act does not apply to transactions by persons other than issuers, underwriters, or dealers, by brokers upon customers' orders, or by persons making intrastate sales. Nor does the act apply to the issuance of securities to existing security holders or other creditors during a reorganization.[20]

> "Applications" for contributions to alleged enterprise engaged in scientific farming, which assured contributors thirty per cent profit from the undertaking, did not come within the enumerated exemptions. (Securities & Exchange Com'n v. Universal Serv. Ass'n, 106 F. [2d] 232)

Any security may be registered with the Federal Trade Commission by filing a registration statement in triplicate, signed by specified persons, and paying a filing fee based upon the maximum aggregate price of the securities but not less

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[18] *Ibid.*, §5.
[19] *Ibid.*, §3.
[20] *Ibid.*, §4; Ch. 404, Title II.

than $25. The information contained in the registration statement is available to the public.[21] If any accountant, engineer, appraiser, or other professional person is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or a valuation for use in connection with the registration statement, the written consent of such a person must be filed with such a statement.[22]

The registration statement of any security, except foreign government securities, must contain information in respect to thirty-two specified facts. These facts pertain to such things as the name of the issuer, the place of incorporation, the place of business, the character of the business, the names of the directors and certain stockholders, the capital stock, the funded debt, the purpose for which the sale of the securities is to supply funds, the remuneration of the officers, the price of the securities, the commissions paid, and the opinion of counsel as to the legality of the issue.[23] The prospectus is required to contain most of the information that is given in the registration statement. The Federal Trade Commission may, however, require other information to be set forth in a prospectus. In the event that a prospectus consists of a radio broadcast, copies thereof must be filed with the Commission under rules and regulations that it may prescribe.[24]

In the event of a false registration statement, the act authorizes a purchaser to obtain damages if he no longer holds the security or to recover what he paid, less any income received, upon a tender of such security. The suit may be brought against: (1) one who signed the registration statement; (2) a director of, or a partner in, the issuer at the time of filing the statement; (3) the professional person who consented to his name being used as having prepared or certified the false statement; (4) a person who, with his consent, is named as being or about to become a director of, or a partner in, the issuer; and (5) the underwriter with respect to such

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[21] *Ibid.*, §6.
[22] *U. S. Statutes at Large 1933-34*, Vol. 28, Ch. 38, §7.
[23] *Ibid.*, Schedule A.
[24] *Ibid.*, §10.

security. None of the foregoing persons are liable, however, under a few specified circumstances, such as when a person resigns from the office in which he was described in the statement before the effective date of the registration statement, or when a person becomes aware of the falsity of a statement and gives public notice thereof and notice thereof to the Commission.[25]

In the event of a sale of a security in violation of the statute, the seller is made liable to the purchaser for the purchase price, less income received thereon, upon a tender of such property, or for damages if the buyer no longer owns the security. The seller is also liable to the same extent in case of a sale by means of a prospectus or a communication that is misleading because of an omission or of an untrue statement of a material fact, provided the buyer does not know of such omission or of such untruth.[26]

Federal Securities Exchange Act.[27] On June 6, 1934, Congress enacted legislation known as the "Securities Exchange Act of 1934." The statute is based upon the theory that transactions in securities conducted upon securities exchanges and over-the-counter markets, and the practices and matters relating thereto, require regulation and control, in order to protect interstate commerce, the national credit, and the Federal taxing power; to protect and make more effective the national banking system and the Federal Reserve System; and to insure the maintenance of fair and honest markets in such transactions.

> The Securities Exchange Act of 1934 "was enacted primarily to protect the investing public by maintaining free, fair and open markets for listed securities and by preventing and punishing abuse of the facilities of the national exchanges upon which such securities are traded." (Smolowe v. Delendo Corporation, 36 F. Supp. 790)

The act declares it to be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means of instrumentality of exchange for the purpose

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[25] *Ibid.*, §11.
[26] *U. S. Statutes at Large 1933-34*, Vol. 28, Ch. 38, §12.
[27] *U. S. Statutes at Large 1933-34*, Vol. 48, Ch. 404.

of using the facilities of an exchange to effect any transaction in a security, unless such exchange is registered as a national securities exchange with the Securities and Exchange Commission, or unless such exchange is exempt from registration by the Commission.[28]

The Securities and Exchange Commission is created by the terms of the statute, and consists of five members who are appointed by the President by and with the consent of the Senate.[29]

Any exchange may become a national securities exchange by filing a registration statement with the Commission, provided such a statement meets the requirements of the act. The statement must contain an agreement by the exchange to comply and to enforce, as far as is within its powers, compliance by its members with the provisions of the statute. The statement is required also to contain information in respect to the organization, the membership, and the procedural rules of the exchange. Copies of the constitution, the articles of incorporation, and the by-laws must accompany the statement, which contains an agreement to give to the Commission immediate notice of any changes. Registration must be refused if the rules of the exchange do not provide for the expulsion, suspension, or disciplining of a member who is guilty of misconduct in trade.[30]

The act makes it unlawful to effect any transaction in security, other than that which is exempt, on a national securities exchange, unless such security is registered with the Commission. A security is registered by filing with the Commission an application accompanied by copies of the articles of incorporation, the by-laws, the trust indentures or corresponding documents, the underwriting arrangements, the voting trust agreements, and the balance sheets and the statements of profit and loss for a preceding period of not less than three years. The application must contain information in respect to: (1) the nature, the organization, and the financial structure of the business of the issuer; (2) the rights and the

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[28] *Ibid.*, §4.
[29] *Ibid.*, §5.
[30] *U. S. Statutes at Large 1933-34*, Vol. 48, Ch. 404, §6.

privileges of the outstanding classes of securities; (3) the terms on which the securities are to be offered or have been offered during the past three years; (4) the directors and certain stockholders; (5) the compensation of officers and directors exceeding $20,000; (6) bonus and profit-sharing arrangements; (7) management and service contracts; and (8) options existing or to be created in regard to the securities.[31]

The act places certain restrictions on practices in connection with exchange transactions. A provision prescribes a margin requirement for an initial extension of credit. Such standards may, however, be changed from time to time by the Federal Reserve Board. Another provision places a restriction on borrowing by members of a national securities exchange by brokers, and by dealers. A provision also prohibits the manipulation of security prices.[32]

The act provides for penalties of one kind or another. Provisions set forth the liability of persons wilfully violating the requirements of the statute or the regulations made thereunder, of persons making misleading statements, of persons who control persons liable under the act, and of persons on contracts made in violation of the statute.[33]

Rights of Members. Members of a corporation by virtue of such membership do not possess a right to participate directly in the management of the business. They are not agents of the corporation merely because they are stockholders. Nor do they possess any rights in the property of the unit by virtue of their relation as members. Any interference by them with the real or personal property held by the corporation is as unjustified as if the same act were committed by a stranger. On the other hand, stockholders do enjoy certain important rights and privileges.

Certificate of Stock. A stockholder has the right to have issued to him a properly executed certificate giving evidence of his ownership of shares.[34] If, on proper demand, the officers

[31] *Ibid.*, §12.
[32] *U. S. Statutes at Large 1933-34*, Vol. 48, Ch. 404, §§7, 8, and 9.
[33] *Ibid.*, §§18, 20, and 32.
[34] *Uniform Business Corporation Act*, §14.

wrongfully refuse to issue a certificate, the member may appeal to the courts for appropriate relief. Thus in some instances specific performance will be granted by a court of equity, or an action of trover may be brought for conversion, or an action for damages may be maintained.[35]

Transfer. The right of a stockholder to transfer his shares has been discussed, and needs no further attention.

Vote. A stockholder is entitled to attend corporate meetings and to vote. This right, although it is ordinarily an incident of stock ownership, may be taken away by express agreement or by charter or statutory provisions.

Change in Capital Stock. When a corporation has been authorized by the legislature to increase its capital stock, the stockholders only have the right to exercise this power, unless the charter gives the power to the directors.

Allotment of Shares. In the event of an increase of the capital stock of a corporation, each stockholder is entitled to subscribe for the number of the new shares in proportion to the number of old shares held. "Otherwise the majority could deprive the minority of their proportionate power in the election of directors and of their proportionate right to share in the surplus, each of which is an inherent, pre-emptive, and vested right of property." [36]

Inspection of Books. A stockholder has the right to be informed as to the business of the corporation. He has the right to inspect the property and books of his corporation so that he can keep himself informed about its condition. At common law the right to examine the corporate books and records is qualified. The stockholder must ask for examination in good faith, for proper motives, and at a reasonable time and place. This matter is frequently regulated by statutory and constitutional provisions.[37] Some of these provisions appear to make

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[35] *St. Romes* v. *Levee Steam Cotton-Press Co.*, 127 U. S. 614, 32 L. Ed. 289.
[36] *Stokes* v. *Continental Trust Co.*, 186 N. Y. 285, 78 N. E. 1090.
[37] *Uniform Business Corporation Act*, §35.

the right absolute, whereas others merely enlarge the common-law rights. The inspection need not be personally made. For example, a stockholder may employ an accountant or an attorney to examine the records for him.[38]

Dividends. Each stockholder is entitled to a proportionate share of the profits when they are distributed. Such funds, when declared available to stockholders, are known as dividends. A declared dividend is a debt owed by the corporation, which a stockholder, after a proper demand, may recover in a proper action.

Surplus. When the corporation is dissolved, the stockholders are entitled to proportionate shares in the division of its assets after all corporate debts have been paid.

Preference. Some stockholders may possess stock, the terms of which give them priority in receiving dividends and sometimes in the division of the surplus at dissolution.

Injunction. In some cases the minority stockholders have the right to seek relief in equity against the fraudulent or ultra vires acts of the majority. "To maintain an action like this for injunctive relief, it must ordinarily appear that the complaining minority stockholder is suffering some pecuniary or other substantial injury as a result of the illegal, reckless, or discriminatory conduct of the majority." [39]

Liabilities of Stockholders. At common law a stockholder is not liable for the contract or tort obligations of the corporation. This is one of the characteristics of this form of business unit which distinguishes it from partnership. The rule is applicable even when all or almost all of the shares are in the possession of one or a few members.

Unpaid Subscriptions. There are a few exceptions, however, to the general doctrine announced above. Stockholders are liable to creditors of an insolvent corporation to the extent of the amount unpaid on the par value of their subscription

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[38] *Cincinnati Volksblatt Co.* v. *Hoffmeister*, 62 Ohio St. 189, 56 N. E. 1033.

[39] *Theis* v. *Spokane Falls Gas Light Co.*, 49 Wash. 477, 95 P. 1074.

contract. Although an agreement to release the unpaid subscriptions may be binding on the corporation, it is not in most states binding upon the creditors. Courts taking this view proceed upon the theory that such a transaction is a fraud upon creditors.

> Statutes may provide: "Every holder of capital stock not fully paid in any stock corporation shall be personally liable to its creditors, to an amount equal to the amount unpaid on the stock held by him, for debts of the corporation contracted while such stock was held by him." (Grander & Co. v. Allen, 214 App. Div. 367, 212 N. Y. S. 356)

Watered Stock. When stock is not paid in full but is issued as though it were, or when services or property are accepted at an inflated valuation as payment, the stock is known as *watered stock*. The holders of such stock are liable to subsequent creditors who are unaware of the facts. "The capital of a corporation is the basis of its credit. It is a substitute for the individual liability of those who own its stock. People deal with it and give it credit on the faith of it. They have a right to assume that it has paid-in capital to the amount which it represents itself as having; and if they give it credit on the faith of that representation, and if the representation is false, it is a fraud upon them; and, in case the corporation becomes insolvent, the law, upon the plainest principles of common justice, says to the delinquent stockholder, 'Make that representation good by paying for your stock.' " [40]

> By statute there may be a liability on the part of both directors and shareholders when "stock has been issued to subscribers and has not been wholly paid for, either in money, property, labor, or services." (Rapides Grocery Co. v. Grant, 165 La. 593, 115 S. 791)

Bonus Stock. Most states hold that donees of stock issued gratuitously are liable to subsequent creditors without knowledge. Thus, when one purchases bonds and receives stock as a bonus, he is liable for the par value thereof to creditors relying on its payment.[41] Most states have statutes governing the issuing of bonus or watered stock. It is generally held

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[40] *Hospes* v. *Northwestern Mfg. Co.*, 48 Minn. 174, 50 N. W. 1117.
[41] *Hebbard* v. *Southwestern Land, etc., Co.*, 55 N. J. Eq. 18, 36 A. 122.

that if the holder of such stock transfers it, the transferee is not liable for the payment in the absence of notice that the par value of the stock has not been paid.

Unauthorized Dividends. It is generally held that a stockholder is liable to creditors for dividends paid out of capital.[42] In some states the liability of the stockholder depends on whether the corporation was insolvent at the time, whether the debts were existing at the time, and whether the stockholders had notice of the source of the dividend.

Statutory Liability. By statutory or charter provisions the liability of the stockholder may be larger than that stated above. Thus a stockholder may be made personally and individually liable for the debts of the corporation.[43] Some statutes make stockholders liable for an amount equal to or twice the par value of the shares owned.

QUESTIONS

1. Crandall displays a certificate of stock to a friend, stating, "This is a contract with a corporation by which the latter guarantees a reasonable return on the money invested." Do you agree with his statement?

2. Lassert orally agrees to take one thousand shares of stock in a given corporation and to pay the par value which is one hundred dollars a share. When the corporation seeks to collect the agreed amount, Lassert refuses to pay on the ground that the agreement is unenforceable because it is not in writing. The corporation brings an action to recover the agreed amount. Is it entitled to judgment?

3. Stewart subscribes for fifty shares of stock in a corporation which is being formed. Nearly two weeks before incorporation Stewart informs all the parties concerned that he does not intend to go on with the transaction. After the corporation is formed, an action is brought against Stewart for the amount of his subscription. Is the corporation entitled to judgment?

4. Veith subscribes to stock in a corporation on condition that one of the company's plants is located in a given city. The cor-

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[42] The Uniform Business Corporation Act makes individual shareholders liable for the repayment of unlawful dividends (1) when no guilty or negligent director is so liable, or (2) when recovery from guilty directors is impossible. §25.

[43] *Southmayd* v. *Russ*, 3 Conn. 52.

poration later constructs a plant in the specified city. Veith refuses to pay for the stock. Is the company entitled to collect?

5. The charter of a corporation engaged in manufacturing clothing authorizes the directors to prescribe the manner of transferring its shares. The directors prescribe that a transfer can only be made with the consent of the directors. Sullivan who owns ten shares of stock transfers them to Riley. Is the latter entitled to have the transfer made on the books of the corporation?

6. A charter of a corporation provides that the shares shall be transferable on the books of the corporation in a manner prescribed by the directors. Wolfe transfers his shares to Yager who does not have a transfer made on the books of the corporation. The company mails a dividend to Wolfe. Yager contends that the corporation is liable to him for the dividend. Is this contention sound?

7. Wilde subscribed for fifty shares of stock. Upon the payment of sixty per cent of the price, a certificate of stock was issued to Wilde, who then sold the stock to Young. The corporation claimed the stock was subject to a lien for the unpaid amount. Do you agree?

8. "Blue sky laws have been enacted for the purpose of protecting persons against investments in fraudulent securities." What is meant by this statement?

9. Byrne is a stockholder in a given corporation. The officers refuse, however, to issue a properly executed certificate giving evidence of his ownership of shares. What remedies, if any, does Byrne possess?

10. The charter of a corporation authorizes the board of directors to increase the capital stock. Under this power the board prescribes that the capital stock be increased by three hundred thousand shares and that the shares be sold at a public auction. A stockholder seeks to enjoin the sale of these shares. Is he entitled to an injunction?

11. A stockholder employs an accountant to examine the books and records of a corporation. The company refuses to allow the accountant to examine them. Is the refusal justified?

12. A corporation issues stock valued at five thousand dollars to Sonnen in return for a piece of property known to be worth only two thousand dollars. Later Splatt becomes a creditor of the corporation. Upon the corporation's becoming insolvent, Splatt brings an action to compel Sonnen to pay the difference between the value of the stock and the price paid for it. Is Splatt entitled to judgment?

Part V—Management

Conduct of Business. Stockholders do not directly participate in the management of ordinary corporate affairs. "No stockholder, whatever his interests, can, without authority from the corporation, bind it by contract, however simple. Corporations must act through boards of directors or through their authorized officers and agents." [1] The stockholders may, however, control indirectly the business activities of the corporation in that they have the right to select the directors and dictate the policies to be followed by them. The will of the majority prevails in selecting directors and dictating policies except when it is exercised unlawfully, in bad faith, or in a fraudulent manner.

> The majority stockholders are "bound to exercise good faith, care, and diligence to protect the rights of the minority." (Backus v. Finklestein, 23 F. [2d] 531)

When a change in the character of the enterprise is contemplated, the consent of all stockholders is required.[2] To illustrate, the unanimous consent of the stockholders is required for the material alteration of a charter to permit an electric lighting company to engage in the operation of a street railway.[3] There is, however, considerable conflict of opinion as to what constitutes a material alteration of the charter. Some courts permit even an extreme change if it carries out the main purpose named by the charter, or if it does not prejudice the rights of the minority.

Meetings. It has been noted that certain corporate functions are exercised by the stockholders. Their acts, however, do not bind the corporation, unless they are performed at a meeting properly held and conducted. A proper meeting depends upon several facts.

Place. The stockholders' meeting, unless permitted by statute, cannot, generally speaking, be held outside of the state

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[1] *Jones* v. *Williams*, 139 Mo. 1, 39 S. W. 486.

[2] The Uniform Business Corporation Act requires, in the absence of a provision in the articles of incorporation, a majority of the voting power to change the name of the corporation, and two thirds of the voting power to alter the articles of incorporation in any other respect. §38.

[3] *State* v. *Taylor*, 55 Ohio St. 61, 44 N. E. 513.

of its creation. Some courts hold that only the first meeting is required to be in the home state. In some states, statutes prohibit meetings outside the state; in others, statutes authorize such meetings.[4] The place of holding stated meetings may be left in the hands of the directors, or it may be prescribed by the charter or by-laws. Unless otherwise prohibited by statute, a meeting improperly held outside of the state is binding on those who assent. For example, when stockholders participate in a meeting held elsewhere than at the place specified in the by-laws, they waive their right to complain.[5]

Regular Meetings. Meetings of the corporation may be regular or special. The time and place of regular or stated meetings are usually prescribed by the charter or by-laws. Notice thereof is ordinarily not required.

> Notice of a regular annual meeting, though time and place are fixed, is necessary when required by a by-law. (In re Mississippi Valley Utilities Corporation, 2 F. Supp. 995)

Special Meetings. A special meeting of the stockholders must be called by the proper officer or group of stockholders. Unless prescribed by charter or by-laws, special meetings are called by the directors. It is sometimes provided that a special meeting may be called by the stockholders. For example, a statute or charter may permit a special meeting at the request of a specified number or at the request of any number provided they own a majority of the stock.[6] Notice of the day, hour, and place of the meeting must be given to all of the stockholders. The notice must include a statement of the nature of the business to be transacted.

> A by-law providing for only five days' notice of a special meeting was held not to be unreasonable. (Moon v. Moon Motor Car Co., 17 Del. Ch. 176, 151 A. 298)

Quorum. A valid meeting requires the presence of a quorum. At common law any number of stockholders assembled at a proper meeting constitute a quorum, and action

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[4] *Uniform Business Corporation Act*, §27.
[5] *Ellsworth* v. *Nat'l Home, etc., Builders*, 33 Calif. A. 1, 164 P. 14.
[6] *Southern Plank Road Co.* v. *Hixon*, 5 Ind. 165.

by the majority of such quorum is binding. "The reason for the common-law rule is obvious. If it were otherwise, the affairs of the corporation, through either the negligence or the malevolence of a majority of the shareholders, might be allowed to go to ruin. We know of no power by which the shareholders can be forced to attend the meeting of the corporation, but the law affords a sufficient remedy for this danger by placing the control of the property in the hands of those shareholders who are sufficiently interested in its affairs to attend the corporate meetings." [7] It is sometimes provided by statute, charter, or by-laws that, in order to constitute a quorum, there must be a specified number of stockholders, or a number representing a certain proportion of the stock.[8]

Voting. The right to vote at stockholders' meetings is an incident to ownership of stock, unless restricted by agreement, charter, or statutory provisions. Ordinarily only those in whose names the stock appears on the books of the corporation are entitled to vote. In some instances the owner is not permitted to vote unless his stock has been registered a specified time before the meeting.[9] For example, a transferee may be denied the right to vote for officers unless the transfer was made on the books ten days prior to the election.[10]

> A statute which provides that only registered stockholders may vote for directors must be read in light of another statute which expressly allows a pledgor of stock to vote even though he is no longer the stockholder of record. (Gow v. Consolidated Coppermines Corp., 19 Del. Ch. 172, 165 A. 136)

Number of Votes. Each stockholder at early common law had but one vote irrespective of the number of shares owned. This rule "has been departed from, and by custom and usage, as well as by statute, it is almost universal now that each

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[7] *Gilchrist* v. *Collopy*, 119 Ky. 110, 82 S. W. 1018.

[8] The Uniform Business Corporation Act requires, in the absence of a provision otherwise in the articles of incorporation, that the holders of a majority of the voting power be present, except at a meeting for the election of directors that has been adjourned twice for lack of such quorum. §30.

[9] *Uniform Business Corporation Act*, §28—(1).

[10] *Matter of Glen Salt Co.*, 17 App. Div. 234; 45 N. Y. S. 568.

stockholder is entitled to one vote for each share of stock." [11] In some states, however, the number of votes allowed to each stockholder is limited by statute. Such restrictions are for the benefit of minority stockholders. For the same purpose some statutes authorize *cumulative voting* in the election of directors.[12] Under this scheme each stockholder is given as many votes as he owns shares multiplied by the number of representatives to be elected, and he can distribute them as he sees fit. To illustrate, if a person owns thirty shares and there are ten directors to be elected, he is entitled to cast three hundred votes. He may cast thirty votes for each of the ten nominees, sixty votes for each of five, one hundred and fifty for each of two, or all of the three hundred votes for one.[13]

> A by-law authorizing cumulative voting was held void, because this method of voting was "not provided for in the charter of the corporation as required by statute." (In re Brophy, 106 N. J. Eq. 163, 150 A. 347)

Voting by Proxy. At common law each vote must be cast personally. By statute, charter, or by-laws, a stockholder is commonly given the right to authorize another to vote for him.[14] This is known as voting by *proxy.* In the absence of restrictions to the contrary, any person, even one who is not a stockholder, may act as proxy. Ordinarily authority to act as a proxy may be conferred by an informal written instrument. Unless it is coupled with an interest, the authority of a proxy can be revoked at any time.

Voting Trusts. Stockholders, as a general rule, are allowed to enter into an agreement by which they concentrate their voting strength for the purpose of controlling the management, unless their agreement is fraudulent or oppressive as to other members. A similar question is presented when the right of voting and ownership are separated by a voting trust. A *voting trust* exists when by agreement a group of stockholders, or all of the stockholders, transfer their shares in

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[11] *Comm.* v. *Smith,* 37 Pa. Co. 625.
[12] *Uniform Business Corporation Act,* §28—(3).
[13] *Schmidt* v. *Mitchell,* 101 Ky. 570, 41 S. W. 929.
[14] *Uniform Business Corporation Act,* §28—(4).

PROXY

Know All Men by These Presents, That I, Samuel Norton of Osage, Iowa, hereby delegate and appoint Andrew Jackson to be my substitute, agent, and attorney for me, and in my name and behalf, to vote at the election of directors or other officers, and at any meeting of the stockholders of the CITY GAS & ELECTRIC LIGHT COMPANY as fully as I might or could do if personally present and acting in my own behalf.

In Witness Whereof, I have hereunto set my hand and seal this second day of January, 19...

WITNESS. Samuel Norton

Jas. Lawton, Jr.

M. R. Smith

PROXY

trust to one or more persons, as trustees, who are authorized to vote the stock during the life of the trust agreement. Some courts categorically deny the privilege to separate the right to vote from that of ownership. Others hold that an irrevocable trust agreement is contrary to public policy. In general, however, such agreements have been upheld if their object is lawful.[15] "Voting trust agreements are valid and binding if they are based upon a sufficient consideration, if they do not contravene public policy or a positive prohibitory statute, and if they do not sound in fraud or wrong against the stockholders." [16]

Directors. The management of a corporation is usually intrusted to a board of directors who are elected by the stockholders. The number of directors to be elected varies, depending upon statute, charter, or by-law. Eligibility for membership to a board of directors is determined by statute, charter, or by-law. In the absence of controlling provisions, any person is eligible for membership—a nonresident, an infant, or even a person who is not a stockholder.[17] Generally, however, it is required that all or some of those seeking mem-

[15] *Uniform Business Corporation Act*, §29.
[16] *Clark* v. *Foster*, 98 Wash. 241, 167 P. 908.
[17] *Uniform Business Corporation Act*, §31—(1).

bership on the board of directors meet certain requirements. For example, it may be required that all or some of them be residents of the state in which the corporation was created.[18]

> Under a statute making ownership of stock a qualification for a director, the mere pretended transfer of stock to a "dummy" by a dominating majority does not qualify such person for the office. (Holcomb v. Forsyth, 216 Ala. 486, 113 S. 516)

Meetings. Corporate actions can as a rule be made by directors only at proper meetings of the board. In the absence of restrictions the meeting may be held outside of the state.[19] "The directors, being mere agents, may meet and transact business in places under the jurisdiction of other governments, where such governments do not forbid it." [20] The statutes, charter, or by-laws sometimes require the meeting to be held at a particular place. A director is not allowed to vote by proxy; he must attend personally to the affairs of the corporation. In contrast with a meeting of stockholders, a quorum requires the presence of a majority of the directors, unless otherwise provided in the charter, statute, or by-laws.[21] In the determination of whether the requisite number of directors to transact business is present, a member ordinarily cannot be counted if he has a personal interest in the matter before the board. Thus one court stated: "A director, whose interest in a matter disqualifies him from voting upon a resolution concerning it, cannot, according to the better opinion, be counted for the purpose of ascertaining whether a quorum is present when the vote is taken." [22]

> When in a directors' meeting suit by the corporation against certain directors is being considered, "the proposed defendants would be disqualified to vote." (Anderson v. Gailey, 33 F. [2d] 589)

Powers. The board of directors, possessing power of general management, may enter into any contract necessary to carry out the business for which the corporation was formed.

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[18] *Horton* v. *Wilder*, 48 Kans. 222, 29 P. 566.
[19] *Uniform Business Corporation Act*, §31—(3)—(c).
[20] *Webb* v. *Midway Lumber Co.*, 68 Mo. A. 546.
[21] *Uniform Business Corporation Act*, §31—(3)—(d).
[22] *Enright* v. *Heckscher*, 240 F. 863.

The board may appoint officers and other agents to act for the company or may delegate authority to one or more of its members. For example, it may appoint several of its own members to form an executive committee to act for the board between board meetings.[23] Unless otherwise provided, the board of directors has sole authority to declare dividends within its discretion. Courts are reluctant to interfere with the discretion of directors in the matter of declaring dividends, and they will do so only when directors are acting fraudulently or are abusing their discretion in not declaring dividends. "The apportionment of net earnings to the payment of cash dividends, stock dividends, increase of capital, reserve, or contingent fund, or to provide for future obligations, is largely one of policy, intrusted to the discretion of the directors, which, when honestly and intelligently exercised, will not be lightly overruled." [24]

> The general rule is "that the directors of a corporation have no authority to vote compensation to themselves." (Schulte v. Ideal Food Products Co., 208 Iowa 767, 226 N. W. 174)

Liability. Directors are not liable for losses resulting from their management when they have acted in good faith, with due diligence, and with reasonably sound judgment.[25] For willful or negligent acts, however, they are held strictly accountable. One court states: "The directors are bound by all those rules of conscientious fairness, morality, and honesty in purpose which the law imposes as the guides for those who are under fiduciary obligations and responsibilities. They are held, in official action, to the extreme measure of candor, unselfishness, and good faith." [26]

Officers. The statute, charter, or by-laws usually provide for the election of certain corporate officers, such as president, vice-president, secretary, and treasurer. Sometimes these officers are appointed by the stockholders, but usually they are

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[23] *Potts* v. *Wallace*, 146 U. S. 689, 36 L. Ed. 1135.
[24] *Excelsior Water, etc., Co.* v. *Pierce*, 90 Calif. 131, 27 P. 44.
[25] *Uniform Business Corporation Act*, §33.
[26] *Kavanaugh* v. *Kavanaugh Knitting Co.*, 226 N. Y. 185, 123 N. E. 148.

appointed by the board of directors.[27] No formality, unless specifically prescribed, need be observed in making such appointments. There are seldom, if ever, particular qualifications required of officers, such as owning stock or being a resident of the state of creation. Unless prohibited, a director may hold an executive office.

> It has been held that "the directors, unless specially authorized, have no power to remove an officer or agent elected or employed by the stockholders." (Stott v. Stott Realty Co., 246 Mich. 267, 224 N. W. 623)

Powers. As the officers of a corporation are merely agents, their powers are controlled by the law of agency. The limits of their authority are determined by the charter and by-laws or by grants from the board of directors. When an officer is installed as general manager, irrespective of the name given to the office, he has the implied power to do such acts as are necessary to carry out the particular business. The authority of other officers, such as secretary or treasurer, is, generally speaking, limited to the duties of their offices. Their authority may, however, be extended by the conduct of the corporation. "The rule is well settled that if a corporation permits the treasurer to act as its general fiscal agent, and holds him out to the public as having the general authority implied from his general name and character, and by its silence and acquiescence suffers him to draw and accept drafts, and to indorse notes payable to the corporation, it is bound by his acts done within the scope of such implied authority." [28] An unauthorized act of an officer may, of course, be ratified as in other relations of principal and agent.

> "General counsel cannot delegate his duties of skill and discretion by the corporation delegated to him." (Central Hanover Bank & Trust Co. v. North Butte Mining Co., 4 F. Supp. 711)

Liability. The relation of the officers to the corporation is of a fiduciary nature.[29] "An officer is but the agent of his corporation, and in all transactions in which its interests are involved he must act for it with unselfish singleness of pur-

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[27] *Uniform Business Corporation Act*, §32.
[28] *Lester* v. *Webb*, 1 Allen (Mass.) 34.
[29] *Uniform Business Corporation Act*, §33.

pose." [30] For this reason the officers are liable for secret profits made in connection with the business of the corporation. They are also liable for willful or negligent acts that cause a loss to the corporation. On the other hand, they are not liable for mere errors in judgment committed while exercising discretionary powers.

QUESTIONS

1. Robbins is a stockholder in a company engaged in the operation of a foundry. The majority of the stockholders approve of an alteration of the charter to permit the company to engage in operating a steel mill. Robbins refuses to consent to the alteration and contends that it cannot legally be made without his consent. Is his contention sound?

2. The charter of a corporation provided that annual meetings should be held at two o'clock on the first Monday in December in the main offices of the company. Strauss was not present at an annual meeting at which the stockholders voted to pursue a policy which had been opposed by Strauss. He later contended that the act of the stockholders was not binding because notice of the meeting had not been given. Was his contention sound?

3. At a special meeting of the corporation only thirty-five shareholders appeared. The business for which the meeting was called required only one action of the stockholders. The proposition was presented to them and was passed by a vote of eighteen to seventeen. Busch contended that the action of the stockholders was not binding. Was his contention sound?

4. Sholl borrows sixteen thousand dollars from Gluck. The latter receives as security a pledge of one thousand shares of stock in a given corporation and authority to vote the stock. Just before a corporate meeting Sholl decides to revoke the authority given to Gluck. Is he entitled to do so?

5. Three stockholders enter into an agreement to transfer their stock to Odgen in trust for five years and to authorize him to vote the stock during that period. At the end of three years one of the stockholders wishes to withdraw from the agreement. He contends that the agreement is not binding. Do you agree?

6. The Brilliant Light Company, a New York corporation, has twelve directors. At a meeting of the board held in New Jersey only five directors appear, but the usual business is transacted. It is contended that the acts of the board at this meeting are not binding. Do you agree?

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[30] *Comm. Title Ins. Co.* v. *Seltzer*, 227 Pa. 410, 76 A. 77.

7. At a meeting of board directors an important proposition is to be voted upon. Several of the members who are unable to attend give proxies to some of the members. The proposed action is approved by the board. The necessary majority is obtained by allowing the members to vote under the proxies of the absent members. Is the action of the board binding?

8. The Sturdy Stove Company earned two hundred thousand dollars annually for a period of three years. The board of directors, however, did not declare a dividend during this period. One of the stockholders brought an action in equity to compel the directors to declare a dividend. He proved that the amount earned was sufficient to pay a four-dollar dividend each year. Was he entitled to a decree?

9. Everson desires to purchase a certain piece of land owned by a corporation. After drawing up a contract to sell, he visits each of the directors of the corporation and secures his signature. Is this contract binding on the corporation?

10. The board of directors of a given corporation decide to wind up the affairs of the corporation. With this in view the directors enter into a contract to sell all of the corporate property to another company. It is contended that they are acting beyond their authority. Do you agree?

11. Hamlin receives credit from a corporation by depositing with it securities valued at ten thousand dollars. Broomell, who is president of the corporation, later surrenders the securities and releases Hamlin from liability without having received payment from the latter. The corporation brings an action on the debt against Hamlin. Is it entitled to judgment?

12. A corporation paid its employees in cash semimonthly. On one occasion while the treasurer, who was also the paymaster, was going from one bank to another to pay the employees, part of the pay-roll money was stolen. Was the treasurer liable to the corporation for the loss?

Part VI—Termination

Insolvency. As a general rule, the insolvency of a corporation does not terminate its corporate existence. "The possession of property is not essential to the existence of a corporation. Its insolvency cannot, therefore, extinguish its legal existence." [1] In some states, statutes expressly or impliedly state that insolvency is a ground for dissolution. Sometimes the statute merely dissolves the corporation as to creditors. In other words, under such statutes the creditors are entitled to pursue those remedies which would exist in the case of actual dissolution. This situation is sometimes called *de facto* or *quasi-dissolution.*

Although the appointment of a receiver does not ordinarily dissolve a corporation, it may in some instances have that effect.[2] To illustrate, when a receiver is appointed to pay the debts and distribute the funds of a corporation, if any, among the stockholders, the corporation is dissolved.[3]

Reorganization. A particular corporation is usually terminated by a reorganization. A reorganization ordinarily can be made only with the consent of the state. It may be accomplished by an agreement of stockholders or by an agreement of stockholders and bondholders.[4] Another method of reorganization in common use is a voluntary or forced sale of the corporate assets and franchises.

> In a suit involving the reorganization of the Lincoln Motor Company, the court said that a contract for the reorganization of a corporation, which excludes a portion of the stockholders from the benefits, "is fraudulent and cannot stand." (Leland v. Ford, 245 Mich. 599, 223 N. W. 218)

Statutes in the different states usually control reorganization procedure. The purchasers at a sale of the property and rights of a corporation may become a corporation by virtue of the purchase or may have power to form a corporation. In either event the new corporation is generally considered as

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[1] *Boston Glass Mfg.* v. *Langdon*, 24 Pick. (Mass.) 49.
[2] *Uniform Business Corporation Act*, §54.
[3] *Dewey* v. *St. Albans Trust Co.*, 56 Vt. 476.
[4] *Uniform Business Corporation Act*, §59.

distinct and separate from the old one. Thus, when a reorganization took place under the terms of a particular statute, the court stated: "We think it is also plain that, under the reorganization acts above mentioned, when the purchasers at the foreclosure sale undertake to reorganize under those acts and for that purpose to file in the secretary's office a certificate, upon the filing of which they become a body politic and corporate, the corporation thus formed is a new and entirely different one from that whose property and franchises the purchasers may have brought under the foreclosure proceedings. It is true that the corporation about to be formed by the filing of the certificate has by force of the statute when formed all the rights, franchises, powers, privileges, and immunities which were possessed before such sale by the corporation whose property was sold; but that does not make the corporation the same by any means." [5]

Consolidation. When two or more corporations consolidate, their separate corporate existences cease and a new corporation results. "Rightly understood, there can never be a consolidation of corporations except where the constituent corporations cease to exist as separate entities, and a new corporation with the property and assets of the old comes into being." [6] Two or more corporations may not consolidate without authority from the state and without the unanimous consent of the stockholders.

> Some statutes allow a consolidation with the consent of less than all, and in such case allow the dissenting stockholders to recover the valuation of their stock in money, in lieu of an allotment of stock in the consolidated enterprise. (Cole v. National Cash Register Assn., 18 Del. Ch. 47, 156 A. 183)

When a consolidation is effected, the new corporation ordinarily succeeds to the rights, powers, and immunities of its component parts.[7] Limitations in this respect may, however, be prescribed by the charter, constitution or statute. As a

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[5] *People* v. *Cook*, 110 N. Y. 443, 18 N. E. 113.
[6] *Collinsville Nat'l Bank* v. *Esau*, 74 Okla. 45, 176 P. 514.
[7] *Uniform Business Corporation Act*, §47.

general rule, the consolidated corporation assumes the burdens and liabilities of the constituent parts. Thus, one court states: "For the purpose of answering for the liabilities of the constituent corporations, the consolidated company should be deemed to be merely the same as each of its constituents, their existence continued in it under the new form and name, their liabilities still existing as before and capable of enforcement against the new company in the same way as if no change had occurred in its organization or name." [8]

Forfeiture of Charter. Corporate existence may be terminated by a forfeiture of the charter. The state alone can bring proceedings to forfeit the charter of a corporation. "This results from the very nature of an act of incorporation. It is not a contract between the corporate body, on the one hand, and individuals whose rights and interests may be affected by the exercise of its powers, on the other. It is a compact between the corporation and the government from which it derives its powers. . . . It would not only be a great anomaly to allow persons, not parties to the contract, to insist on its breach, and to enforce a penalty for its violation; but it would be against public policy, and lead to confusion of rights, if corporate powers and privileges could be disputed and defeated by every person who might be aggrieved by their exercise." [9] The legislature may, and sometimes does, make the forfeiture clause of the statute self-executing. In other words, the statutory or charter provision may prescribe that certain acts constitute an immediate forfeiture of all rights and powers, or an ipso facto termination of corporate existence.

> "It is competent for the Legislature to provide that a corporation shall lose its existence by acts or omissions, the forfeiture to be declared by administrative officers without the intervention of the courts." (A. R. Young Const. Co. v. Dunne, 123 Kans. 176, 254 P. 323)

One of the common grounds for a forfeiture is fraudulent incorporation.[10] To illustrate, if a certain number of subscriptions in good faith are required, and some of the subscribers

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[8] *Indianapolis, etc., R. R. Co.* v. *Jones*, 29 Ind. 465.
[9] *Heard* v. *Talbot*, 7 Gray (Mass.) 113.
[10] *Uniform Business Corporation Act*, §51.

are known by the incorporators to be insolvent, the charter may be forfeited.[11] The charter may also be forfeited on grounds of willful *nonuser*. Thus, when a corporation is formed to conduct agricultural exhibitions, fairs, and races, and exercises only the last-named power, the state may annul its charter.[12] Another common ground for a forfeiture exists in case of *misuser*. Misuser is the abuse of corporate powers and franchises. When, however, it is claimed that a corporation has abused its privileges, such acts must be willful, serious, and injurious to the public. "The State does not concern itself with the quarrels of private litigants. It furnishes for them sufficient courts and remedies, but intervenes as a party only where some public interest requires its action. Corporations may, and often do, exceed their authority where only private rights are affected. When these are adjusted, all mischief ends and all harm is averted. But where the transgression has a wider scope and threatens the welfare of the people, they may summon the offender to answer for the abuse of its franchise or the violation of its corporate duty." [13]

Dissolution by Agreement. A corporation may end, in accordance with an agreement between it and the state, in one of several ways.[14]

Repeal. The corporation may be formed with the understanding that the legislature may terminate its existence at will or upon the happening of a certain contingency. This right may be contained in provisions of the charter, statutes, or constitution. In exercising the rights of repeal, however, the state cannot impair vested rights. To illustrate, if the legislature repeals a charter, it cannot take the assets of the corporation from the stockholders or creditors.[15]

> The power of the Legislature to repeal a corporate law, provided in the Constitution, "could not be limited, suspended, or bargained away by any act of the Legislature." (Detroit Trust Co. v. Allinger, 271 Mich. 600, 261 N. W. 90)

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[11] *Holman* v. *State*, 105 Ind. 569, 5 N. E. 702.
[12] *State* v. *Delmar Jockey*, 200 Mo. 34, 98 S. W. 539.
[13] *People* v. *North River Sugar Refining Co.*, 121 N. Y. 582, 24 N. E. 582.
[14] *Uniform Business Corporation Act*, §50.
[15] *Lathrop* v. *Stedman*, 42 Conn. 533, 15 Fed. Cases 8,519.

Surrender of Charter. Stockholders may terminate the corporation by surrendering their charter to the state. A surrender requires more than a corporate resolution to that effect, as the corporation is not allowed to abandon its rights and privileges at will. "The surrender of a charter can only be made by some formal act of the corporation; and it will be of no avail until accepted by the government. There must be the same agreement of the parties to dissolve, that there was to form the compact. It is the acceptance which gives efficacy to the surrender. The dissolution of a corporation, it is said, extinguishes all its debts. The power of dissolving itself by its own act would be a dangerous power, and one which could not be supposed to exist." [16]

> When a corporation surrenders its charter, "no creditor being involved, the property of such corporation revests to the stockholders." (Jamison v. Henderson, 189 Ark. 204, 71 S. W. [2d] 696)

Expiration of Time. Some states hold that upon the expiration of the period fixed for corporation existence, the corporation continues as a de facto corporation. Most states, however, hold that at the end of such a period, corporate existence ipso facto ceases. Thus one court says: "If the law under which a corporation is organized, or the special act creating the corporation, fixes a definite time when its corporate life must end, it is evident that, when that date is reached, said corporation is ipso facto dissolved without any direct action on the part of the state or its members." [17]

QUESTIONS

1. A corporation was formed for the purpose of operating a ferry on a given river. After several prosperous years the earnings of the company began to decrease rapidly. Finally the company became insolvent. Later an action was brought in the corporate name on a debt which Burkland owed the company. Burkland's defense was that the corporation was dissolved, and an action could not be brought in its name. Was the corporation entitled to judgment?

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[16] *Boston Glass Mfg.* v. *Langdon*, 24 Pick. (Mass.) 49.
[17] *Clark* v. *American Cannel Coal Co.*, 165 Ind. 213, 75 N. E. 1083.

2. The creditors of a corporation meet for the purpose of deciding whether they will apply for the appointment of a receiver. Some of the creditors favor the plan, and others oppose it. The objection to the appointment of a receiver is based upon the ground that such an appointment will dissolve the company. Is the contention of the opposing creditors sound?

3. A statute pertaining to the reorganization of corporations provides that the purchasers of the corporate property at a foreclosure sale may, by meeting certain requirements, form a corporation with all of the rights and powers of the corporation whose property was sold. It is contended that the corporation formed by the purchasers under this statute is the same as the corporation whose property was sold. Do you agree?

4. The stockholders of the Bildmore and the Bildbetter Corporations decided to consolidate. At appropriate meetings of the companies, resolutions were enacted for this purpose, in spite of the difference of opinion voiced by the attorney for each corporation, as to the validity of their proceedings. The Bildmore's attorney contended that the proceedings were irregular, because the consent of the state to effect the consolidation had not been obtained. The attorney for the Bildbetter Corporation contended that the stockholders did not need the consent of the state for this purpose. With which attorney do you agree?

5. Two corporations are authorized by statute to effect a consolidation. A majority of the stockholders of each company approve the proposed consolidation. A minority of the stockholders of each corporation, however, oppose the proceedings and contend that the consolidation cannot be made without their consent. The majority stockholders contend that their consent is not necessary, particularly in view of the fact that the consolidation, being made to effect numerous economies, will be a beneficial act. Do you agree with the majority or with the minority stockholders?

6. The Eureka Gas-Light Company and the Eureka Electric Light Company are authorized by the legislature and their stockholders to effect a consolidation. The consolidated company is called the United Gas and Electric Company. The Eureka Gas-Light Company at the time of consolidation is entitled to certain bonds from a municipal corporation. The United Gas and Electric Company is now seeking to enforce this claim. May it do so?

7. A corporation was formed under a statute which required corporations to keep their books and records within the state. The company removed its books to another state and refused to return them to the state of its creation. An action was brought by the state to forfeit the charter. Was it entitled to judgment?

8. A statute required that one half of the capital stock had to be actually paid up before any corporation organized under its provisions

might commence business. The Washington Loan and Building Association was incorporated under this statute and commenced to do business when only one fourth of its capital stock was actually paid up. The state brought an action to forfeit the charter. Was it entitled to maintain the proceedings?

9. A railroad company brought condemnation proceedings to acquire a given piece of land by right of eminent domain. The owner proved that the company had been guilty of an abuse of its powers in the past, which was clearly sufficient ground for forfeiture of its charter. Was this a valid defense in the condemnation proceedings?

10. "In the surrender of a charter there must be an agreement of the parties the same as there was in the formation of the compact." What is meant by this statement?

CASES FOR REVIEW

1. The Edgar Collegiate Institute was incorporated under the laws of the state of Illinois for the purpose of establishing and maintaining an institution of learning. It failed to maintain such an institution for a period of ten years, during which time its property was exempt from taxation and its buildings were sold and removed. E. P. Hardy, state's attorney, brought an action against the corporation to obtain a forfeiture of its charter. Was he entitled to judgment? (Edgar Collegiate Institute v. People, 142 Ill. 363, 32 N. E. 494)

2. The Weaver Power Company brought a proceeding for the purpose of winding up the affairs of the Elk Mountain Mill Company, an insolvent corporation. Mary A. Stewart held some stock of the Elk Mountain Mill Company. She petitioned to have her stock declared to be a debt of the corporation, to the end that she might share pro rata with the creditors in the assets of the company. Was her petition granted? (Weaver Power Co. v. Elk Mountain Mill Co., 154 N. C. 76, 69 S. E. 747)

3. The Plymouth Gold Mining Company, a corporation of Gould, Montana, entered into an agreement to purchase four thousand shares of its own stock from James Porter and George Swan for the sum of $2,000. Thereafter it refused to accept and pay for the stock as agreed. In an action brought by Porter and Swan against the corporation, it was contended that a corporation has no implied power to purchase its own stock. Do you agree? (Porter v. Plymouth Gold Min. Co., 29 Mont. 347, 74 P. 938)

4. The New York Electrical Workers' Union was a corporation organized under the laws of the state of New York. Without giving notice thereof, it held its annual meeting at the time fixed by the by-laws of the organization. Thereafter, during litigation between the corporation and William J. Sullivan and others, it was contended that the fore-

going meeting was not properly held. Do you agree with this contention? (New York Electrical Workers' U. v. Sullivan, 122 App. Div. 764, 107 N. Y. S. 886)

5. The American Pig-Iron Storage Company was authorized by its charter to issue fifteen thousand shares of stock at a par value of $100 each. All the shares were subscribed for and, upon two assessments of five per cent cash, the sum of $150,000 was paid in to the corporation. A statute provided that corporations shall pay an annual license fee or franchise tax of one tenth of one per cent of the amount of its capital stock. The State Board of Assessors contended that the storage company was liable for one tenth of one per cent of $1,500,000. Do you agree? (American Pig-Iron Storage Co. v. State Board of Assessors, 56 N. J. L. 389, 29 A. 160)

6. J. R. Ward and Arthur K. Smith each owned 4,099 shares of stock in the J. R. Ward Auction Company, a corporation. Ward assigned his stock to the Central Savings Bank to secure the payment of the sum of $1,554. At this time he owed the sum of $833.02 to the auction company. During subsequent litigation it was contended that the auction company at common law had a lien on the stock of Ward for the amount he owed to it. Was this contention sound? (Central Savings Bank v. Smith, 43 Colo. 906, 95 P. 307)

7. The Independent Medical College was incorporated for the purpose of establishing an institution of learning, for promoting mental and physical culture, and for teaching medical courses and granting degrees. It conferred degrees for a price, without regard to the qualification or fitness of the applicant to practice medicine. Edward C. Akin, attorney general, brought an action against the corporation to obtain a forfeiture of its charter. Was he entitled to judgment? (Independent Medical College v. People, 182 Ill. 274, 55 N. E. 345)

8. The Pan-American Match Company, a corporation organized under the laws of the state of Delaware, had its manufacturing plant, principal office, and books in the city of Worcester, Massachusetts. Some shares of its stock were owned by James P. Klotz, who made a demand to inspect the books. The demand was refused until the directors saw fit to grant the inspection. Klotz brought an action against the company, contending that the action of the directors was illegal. Do you agree? (Klotz v. Pan-American Match Co., 221 Mass. 38, 108 N. E. 764)

9. At a meeting of the stockholders of the Home Savings & Trust Company, the members voted to adopt a plan of voluntary liquidation. E. C. Spinney, the secretary, voting in favor of the proposition, cast votes, in addition to his own, for 5,000 shares owned by 882 stockholders, under proxies. In an action brought by McKee and other stockholders against the corporation, it was contended that under the common law stockholders could not vote by proxy. Was this contention sound? (McKee v. Home Savings & Trust Co., 122 Iowa 731, 98 N. W. 609)

10. Cornelius J. Kelleher had in his possession an electric piano belonging to the Denver Music Company. With knowledge that the company claimed to be a corporation, he negotiated with the company for the purchase of the instrument. Thereafter the company brought an action against Kelleher to recover possession of the piano. Kelleher, as a defense, questioned the corporate existence of the company. Was he entitled to do so? (Kelleher v. Denver Music Co., 48 Colo. 212, 109 P. 860)

11. Johnson was a promoter of the Cushion Heel Company, incorporated to operate a shoe factory in the city of Fort Wayne, Indiana. Before the corporation was created, he entered into an agreement to pay O. M. Hartt for his time and services in obtaining subscriptions. When Johnson failed to pay the agreed compensation, Hartt brought an action against the corporation to recover the agreed amount. Was he entitled to judgment? (Cushion Heel Shoe Co. v. Hartt, 181 Ind. 167, 103 N. E. 1063)

12. The Haskell-Shaw Printing Company, a corporation doing business in Kansas City, Missouri, had a board of directors consisting of five members. At one meeting two members, W. L. Haskell and G. C. Wattles, attended and decided to make an assignment of certain corporate assets to Charles D. Parker. In an action brought by the Calumet Paper Company against the printing company, it was contended that the action of the directors was invalid. Do you agree? (Calumet Paper Co. v. Haskell-Shaw Printing Co., 144 Mo. 331, 45 S. W. 1115)

13. The Columbia Chemical Company was incorporated under the laws of the state of New York for the purpose of manufacturing and selling chemicals. Thereafter a group of persons filed incorporation papers for an organization having the name of Columbian Chemical Company. In an action brought by the state, at the instigation of the Columbia Chemical Company, against James F. O'Brien, secretary of state, it was contended that the second company had no right to adopt such a name. Do you agree? (People v. O'Brien, 101 App. Div. 296, 91 N. Y. S. 649)

14. B. M. Long and his wife, Amanda C. Long, executed to the Georgia Pacific Railway Company a deed conveying their iron, coal, and oil interests in certain tracts of land, aggregating four thousand acres. The company paid the agreed purchase price to the Longs. At the time of the transaction, the company had no power or authority to purchase and hold such property. Because of this fact, the Longs brought an action against the company to rescind the deed and recover the property. Were they entitled to judgment? (Long v. Georgia Pac. Ry. Co., 91 Ala. 519, 8 S. 706)

15. A Texas statute provided that when a foreign corporation forfeits its right to do business in the state, no other corporation to which it may transfer its property and business, or which may assume its obligations, shall be permitted to incorporate or do business in the state. The Waters-Pierce Oil Company, chartered in Missouri, forfeited

its right to do business in Texas. Thereafter it transferred its property and business to the Pierce Oil Corporation, chartered in Virginia, which assumed the payment of its obligations. The Pierce Oil Company brought an action to compel F. C. Wienert, secretary of state, to issue a permit to do business in the state of Texas. Was it entitled to judgment? (Pierce Oil Corporation v. Wienert, 106 Tex. 435, 167 S. W. 808)

16. The Fountain Head Railroad Company entered into an agreement whereby it made a subscription for $100,000 of the stock of the Knoxville & Fountain City Land Company. Mary J. McCampbell, a stockholder of the Fountain Head Railroad Company, brought an action against the railroad company, contending that the company had no implied power to make such a contract. Was this contention sound? (McCampbell v. Fountain Head R. Co., 111 Tenn. 55, 77 S. W. 1070)

17. John F. Byer brought an action against W. C. Woolpert and others to obtain the dissolution of the North American Coal & Mining Company, a corporation organized under the laws of the state of Minnesota. Among other things, he contended that the stockholders of a private corporation may surrender the charter without the consent of the state. Do you agree with this contention? (Byer v. Woolpert, 99 Minn. 475, 109 N. W. 1116)

18. Charles Hammond owned one hundred and forty shares of the stock of the Edison Illuminating Company of Detroit. At a meeting of the stockholders it was decided to increase the amount of stock of the corporation. Hammond contended that he was entitled to purchase twenty-seven shares of the new stock, which represented his pro rata share of the increase. Was his contention sound? (Hammond v. Edison Illuminating Co., 131 Mich. 79, 90 N. W. 1040)

19. Ira P. Smith and H. H. Winchester, partners, subscribed for two hundred and fifty shares of stock of the Craig Silver Company, a corporation organized under the laws of West Virginia. Thereafter the organization incorporated under the laws of Connecticut. Shares of the Connecticut corporation were tendered, but the partners refused to accept and pay for them. The corporation brought an action to recover on the subscription contract. Was it entitled to judgment? (Craig Silver Co. v. Smith, 163 Mass. 262, 39 N. E. 1116)

20. A statute of the state of Wisconsin authorized the members of a church to organize as a corporation. Under this statute, two churches attempted in good faith to organize as a corporation. The organization thereafter admitted that it was not a corporation de jure but contended that it was a corporation de facto. Do you agree with this contention? (Evenson v. Ellingson, 67 Wis. 634, 31 N. W. 342)

CHAPTER XII

PROPERTY

Part I—General Considerations

Introduction. Business in a co-operative society consists mainly of transactions involving rights and interests in things tangible and intangible, known as *property*. This feature of business is inevitable in a co-operative exchange society which recognizes and sanctions the right of private property. Not only does property itself constitute the subject matter of most business enterprises, but the incidents thereof, the exclusive right of possession, use, enjoyment, and disposal, are the forces motivating most economic activities.

The law of property is of ancient origin, although the legal principles in respect thereto have developed and changed to a large extent during the passing years. Transferability as an incident to property was recognized at a much earlier date in the case of movable things than in the case of immovables. At one time trade and commerce concerned itself only with movables. In the course of time transferability as an incident to immovables became recognized; but, because of the influence of the feudal tenure system, the rules and principles governing the transfer of immovables were strict, cumbersome, and ill-adapted to the needs of commerce and trade. Although most of the old methods of transferring interests in immovable things have been abandoned, they are not only of historical interest, but also form the background of which an appreciation is helpful in understanding the modern law. The law of property has not only been influenced greatly by the old feudal rules, but also has distinctive traces thereof in some phases of the subject.

Business today cannot escape the legal problems arising out of and centering around property. The small trader, as well as the merchant prince, to some extent deals in property. Everyone engaged in commercial affairs—the vendor, the financier, the buyer, the warehouseman, the carrier, and the

riskbearer—has daily transactions which directly or indirectly involve rights and interests in things, movable or immovable, tangible or intangible. Some appreciation of the institution of property is desirable for one undertaking to carry on economic activities. He should have some knowledge, at least, of the legal concept of property, the nature and classes of rights and interests in things, and the common methods of acquiring and disposing of such interests and rights.

Definition. Property means the rights and interests which one has in anything subject to ownership, whether such thing be real or personal, tangible or intangible, visible or invisible. Property has been defined as "the right of any person to possess, use, enjoy, and dispose of a thing." [1] The term does not, however, necessarily imply all of these rights, and it is properly used to indicate any one of them. A right in a thing is property, although such a right is absolute or conditional, perfect or imperfect, legal or equitable.

> "'Property' is a generic term, including both real estate and personal property." (State v. Broad River Power Co., 177 S. C. 240, 181 S. E. 41)

The term *property* is also commonly used to designate the thing itself in which one has rights or interests. In this connection, the term *ownership* is employed synonymously with the term *property* as defined above. Hence, one is said to be the owner of a certain property, meaning that he has certain rights or interests in the designated thing. Although the term *ownership* or *owner* is often used to indicate that one has the highest rights possible to possess, either may be used when one does not have all of the rights in a thing.

Classification. Property may be divided in several ways, but the usual classification is real property and personal property. The terms *real* and *personal* are derived from forms of actions, called real actions and personal actions, which were used in seeking redress for wrongs to property, according to the nature of the remedy desired or allowed.

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[1] *Smith* v. *Furbish*, 68 N. H. 123, 44 A. 398.

Property may also be classed in terms of its ownership as public property and private property.

Real Property. Real property technically means an interest of indeterminate or unfixed duration in things real. In other words, it means the rights and interests of a certain nature which one has in lands and things closely pertaining thereto. One may loosely and without strict accuracy define real property in terms of things immovable, as the rights and interests one has in things immovable. The term *real property* is often used to designate the object in which one has rights or interests. In this sense, one speaks of the land itself as real property.

> "The term *property*, although frequently applied to the thing itself, in strictness means only the rights of the owner in relation to it." (Newmarket Mfg. Co. v. Town of Nottingham, 86 N. H. 321, 168 A. 892)

Personal Property. Personal property technically means any interest of determinate or fixed duration in things real and any interest in all other things known as things personal. A loose general definition of personal property may be made in terms of movables, as rights and interests in anything movable. This is clearly inaccurate, however, as it includes certain rights and interests in lands or immovables which are also considered personal property. As in the case of real property, the term *personal property* is commonly used to designate the object of one's rights. In this sense, an automobile or watch is known as and is called personal property. The objects in which one has rights and interests, known as personal property, are also called *chattels.*

> "The word 'chattels' is derived from the Norman French; its meaning being goods of every kind, every specie of property movable, which is less than freehold." (United States v. Sischo, 262 F. 1001)

Public Property. This is a term employed to designate such things as are owned by some governmental agency, such as the state or municipality. To illustrate, state institutions and city parks, which are both created and maintained with

public funds for the public benefit, are classed as public property.[2]

Private Property. The term *private property* is used to designate such things in which one or more individuals have exclusive rights. Such things remain private property if owned by individuals or corporations, even though they are used for or by the public. For example, the equipment of a transportation company owned by individuals is private property, although there exists an obligation which requires the use of the equipment for or by the public.[3]

Limitations on Ownership. When one has the greatest degree of property, or, in other words, all possible existing rights in and over a thing, he is said to have *absolute* ownership. This, in general, means the right freely to use, enjoy, and dispose of a thing exclusive of all other persons. The term *absolute*, however, is somewhat misleading, for one's rights in respect to the use, enjoyment, and disposal of a thing are not without certain restrictions.

Taxation. All the property of an individual is subject to the right of the government to compel the owner to give up a part for public purposes. This right is one of the most important and most prevailing of the powers of government; it is known as the power to tax. It is an inherent right of sovereign states, and "while it may be regulated and limited by the fundamental law, it exists 'independently of it as a necessary attribute of sovereignty.'" [4]

> Property used for nonprofit school purposes comes within a Constitutional exemption from taxation of all property of beneficent and charitable organizations used for charitable and beneficent purposes. (School of Domestic Arts and Sciences v. Carr, 322 Ill. 562, 153 N. E. 669)

Eminent Domain. Another limitation on absolute ownership is the power of the government to take private property for public purposes. This is the right of *eminent domain.*[5]

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[2] *Owensboro* v. *Comm.*, 105 Ky. 344, 49 S. W. 320.
[3] *State* v. *Neff*, 52 Ohio St. 375, 40 N. E. 720.
[4] *People* v. *Reardon*, 184 N. Y. 431, 77 N. E. 970.
[5] *Post*, p. 743.

Police Power. The property of an individual is also subject to the power of the government to pass reasonable rules and regulations in respect to the use and enjoyment thereof, for the protection of the safety, health, morals, and general welfare of the community. Thus, "under the police powers of a municipality it may prohibit the erection of insecure billboards within its limits, prevent the exhibition from secure ones of immoral or indecent advertisements or pictures, and protect the community from any actual nuisance resulting from the use of them." [6]

> "Police force" is used to mean "the body of men appointed to preserve the peace and good order of a city or town, and no one would ever suppose that the intention was to refer to that extensive, if not undefinable, power usually spoken of as the 'police power.'" (City of Florence v. Brown, 49 S. C. 332, 26 S. E. 880)

Creditors. Another restriction on the property of an individual is that the law requires in general that it be subject to the rights of creditors. The property of an individual may be taken by proper judicial proceedings to satisfy just claims during the life of the debtor or after his death. A person cannot dispose of his property by will so as to defeat the rights of his creditors, for the law requires that a man "be just before being generous."

Rights of Others. The law also restricts an individual in the use and enjoyment of his property in that he is not allowed to use it in a way so that it will injure another member of society. It is an accepted doctrine that the process by which people form a body politic authorizes "the establishment of laws requiring each citizen to so conduct himself, and so use his own property, as not unnecessarily to injure another." [7]

Forms of Ownership. As a general rule, all interests in a particular object of property are held by one person alone. This is known as holding property in *severalty.* It may occur, however, that others have concurrent interests in the same

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[6] *Bryan* v. *City of Chester,* 212 Pa. 259, 61 A. 894.
[7] *Munn* v. *Illinois,* 94 U. S. 113, 24 L. Ed. 33.

object. Such interests are known by different names in accordance with their nature.

Joint Tenancy. A joint tenancy exists when two or more owners have identical interests in a given object. In other words, there must be unity of interest, of title, of time, and of possession. The tenancy is terminated whenever any one of these unities is destroyed. To illustrate, where Ruckman and Eyser own property as joint tenants, the tenancy is terminated if the latter conveys his interest to a third party.[8] An important feature of this form of ownership is that, if it is not terminated before the death of one of the parties, the remaining tenant or tenants take the share of the deceased, and finally the last survivor takes the property as a holder in severalty. Courts do not favor this form of ownership and will construe a transfer of property to several persons to be a tenancy in common whenever possible. Statutes in many states have abolished or modified the joint tenancy, especially as to the doctrine of survivorship.

> By statute, "a conveyance to two or more persons creates the relation of tenants in common unless the intention to vest an estate in joint tenancy is clearly manifest." (Shipley v. Shipley, 324 Ill. 560, 155 N. E. 334)

Tenancy in Common. A tenancy in common exists when two or more persons own undivided interests or shares in a given thing. The only unity in this form of ownership is of possession. Thus tenants in common may have different interests, receive title from different parties, and at different times.[9] This tenancy is terminated only when there is a partition giving each a specific portion or when one person acquires all the interests of the co-owners. The interests of a tenant in common may be transferred or inherited, in which case the taker becomes a tenant in common with the others.

Other Forms.[10] At common law a *tenancy by entirety* was created when property was transferred to husband and wife in such manner as to create a joint tenancy in other persons.

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[8] *Davidson* v. *Heydon*, 2 Yeates (Pa.) 459.
[9] *Spencer* v. *Austin*, 38 Vt. 258.
[10] Tenancy in partnership has been discussed previously in Chapter X, p. 620.

It differs from the latter, however, in that the right of survivorship could not be extinguished by a conveyance of the interest of one to a third party. In some states, statutes give the husband and wife a *community* interest in property acquired jointly. The provisions of these statutes vary. Some provide for the right of survivorship; and others provide that half of the property of the deceased husband or wife shall go to the heirs, or permit such half to be disposed of by will.[11]

QUESTIONS

1. "A consideration of the law of property is important in the study of business." Why is this statement true?

2. It is contended that at early common law the rules governing the transferability of immovables were better adapted to commerce and trade than the rules governing the transferability of movables. Do you agree?

3. Burnside is given one tenth of one share of stock in a corporation which has been formed to drill for oil. Does the right or interest of Burnside constitute property?

4. Madden has a one-third interest in an automobile. Is this right or interest known as real or personal property?

5. Bayliss and Kain own and operate a gas company. Is the equipment used to maintain the service rendered by this company considered to be private or public property?

6. Cornish is the absolute owner of a factory. The legislature enacts a statute prescribing that all factories must be equipped with adequate fire escapes. May Cornish be compelled to comply with the requirements of this law?

7. Carroll wishes to dispose of his property by will so as to evade payment of his debts. May he do so?

8. Millard lives in a residential district of a city. He constructs a building on the rear of his lot and starts to manufacture a fertilizer product. Is Fillmore, whose home is on the adjoining lot, entitled to complain of Millard's use of his property?

9. Mydall owns a hunting cap, and Sippy owns a hunting bag. Together, they own a double-barreled shotgun. Indicate which objects of property, if any, are held in severalty.

10. Hinton owns forty acres of farm land. He transfers one half of his interest in the property to Sims. The latter transfers one half of his interest in the land to Berry. Are Hinton, Sims, and Berry tenants in common or joint tenants?

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[11] *Brown* v. *Pritgen*, 56 Tex. 124.

Part II—Real Property

Lands, Tenements, and Hereditaments. Real property, as noted above, means the rights one has in things real. Things real are defined as lands, tenements, and hereditaments.

Lands. The term *lands* means more than merely some part of the surface of the terrestrial globe. It embraces, of course, the soil or earth. In addition, however, it includes all things of a permanent nature affixed to the ground, soil, or earth, such as herbs, grass, or trees, and other growing natural products. The term also includes the waters upon the ground, and such things as are imbedded beneath the surface within the soil or earth. For example, coal, oil, or marble imbedded beneath the surface form part of the land.[1] Technically, land is considered as extending downward and upward indefinitely. Thus one cannot mine a tunnel at any depth beneath the surface of another's land, or build a structure which extends over it at any height, without violating the rights of the owner.[2] How far an owner's right extends above the land is at present an unsettled question. The Uniform Aeronautics Act states that the owner of land owns the space above, subject to the right of flight in aircraft which does not interfere with the use of the land and is not dangerous to person or property lawfully on the land.

> The Uniform Aeronautics Act has been adopted in Ariz., Del., Ga., Hawaii, Ida., Ind., Md., Mich., Minn., Mo., Mont., Nev., N. J., N. C., N. D., Pa., S. C., S. D., Tenn., Utah, Vt., and Wis. (Uniform Laws Annotated, vol. 11, Cumulative Annual Pocket Part for use during 1947)

Tenements. The term *tenements* is often used in a restricted sense to indicate houses and other buildings. It is a word, however, which when properly used comprehends more than the word *land.* "In its original, proper, and legal sense, it signifies everything that may be holden, provided it be of a permanent nature, whether it be of a substantial and sensible or of an unsubstantial, ideal kind." [3]

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[1] *Lime Rock R. Co.* v. *Farnsworth,* 86 Me. 127, 29 A. 957.
[2] *Murphy* v. *Bolger,* 60 Vt. 723, 15 A. 365.
[3] 2 *Blackstone Comm.,* p. 17.

Hereditaments. The term *hereditaments* is more comprehensive than the word *tenements*. It embraces both lands and tenements, and also includes in general all inheritable things. Thus, "an heirloom, or implement of furniture which by custom descends to the heir together with a house, is neither land nor tenement, but a mere movable; yet, being inheritable, is comprised under the general word 'hereditament'; and so a condition, the benefit of which may descend to a man from his ancestor, is also an hereditament." [4] Hereditaments may be of two kinds: a *corporeal* hereditament, such as an heirloom, or an *incorporeal* hereditament, such as an easement.

Freehold Estates. At common law a freehold estate is one of uncertain duration, carrying with it feudal obligations. It may be an *estate of inheritance* or an *estate not of inheritance*. The former is "one which descends or may descend to the heir upon the death of the ancestor." [5] Estates of freehold are classified as an estate in fee simple, an estate in fee tail, and an estate for life. The last is a freehold not of inheritance.

Estate in Fee Simple. An estate in fee, in fee simple, or in fee simple absolute, is the largest estate known to our law. The owner of such fee has the absolute and entire property in the land. The important characteristics of this estate are as follows: (1) it is alienable during life; (2) it is alienable by will; (3) it descends to heirs generally if not devised (transferred by will); (4) it is subject to dower and curtesy; and (5) it is liable for debts of the owner before or after death.

> "The terms 'fee,' 'fee simple,' and 'fee simple absolute' are equivalent terms." (Boon v. Boon, 348 Ill. 120, 180 N. E. 792)

Estate in Fee Tail. When an estate was given to a person and the heirs of his body, it descended from that person to his heirs, then to their heirs, until failure of issue, whereupon it reverted to the donor or his heirs. This estate, known

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[4] 2 *Blackstone Comm.*, p. 18.
[5] *Quinn* v. *Ladd*, 37 Oreg. 261, 59 P. 457.

as an *estate in fee tail* or an *estate tail*, was established by statute.[6] An estate tail may be limited to the heirs of the donee by a particular wife, in which case it is known as a fee tail special as distinguished from an estate tail general. Either of these may also be limited to male or female heirs. The important characteristics of an estate tail are as follows: (1) it is alienable for the life of the tenant only; (2) it cannot be devised; (3) it descends to the heirs specially named in the grant; (4) it is subject to dower and curtesy; and (5) it is liable for the debts of the tenant before death to the extent of his life estate.

Estates of this kind were not favored, because of the many evils accompanying them, such as frauds on creditors; consequently, the courts later allowed the rights of the children and the donor to be cut off by collusive and fictitious proceedings. Most of our states have enacted legislation which either abolishes the estate tail entirely or modifies the rights of the parties. For example, the statute may prescribe that the tenant in tail has a life estate, and his children take an estate in fee simple.[7]

In Pennsylvania a statute has given the tenant in tail a fee simple estate. (Cross v. Dye, 259 Pa. 207, 102 A. 816)

Estate for Life. A freehold interest in land which may extend during, but not beyond, the life or lives of one or more designated persons, is known as a life estate. If the life of one other than the tenant is the measure of the estate, it is called the estate *pur autre vie*. The important characteristics of an estate for life are: (1) it is alienable to the extent of its duration; (2) it does not descend to the heirs;[8] (3) it cannot be devised; (4) it is liable for debts of the tenant to the extent of his interest; and (5) the tenant is liable for waste.

A life estate may be expressly created by deed or devise, and by operation of law. The former class is known as *conventional* life estates. Of the latter class, curtesy and dower are the most important types.

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[6] *Statute de donis conditionalibus*, 3 Edw. 1, ch. 1.
[7] *Wilson* v. *Wilson*, 46 N. J. Eq. 321, 19 A. 132.
[8] An estate *pur autre vie* may be transferred by descent or devise.

Conditional Estates. An estate on condition is one "where the estate granted has a qualification annexed, whereby the estate shall commence, be enlarged, or be defeated, upon performance or breach of such qualification or condition." [9] These qualifications are of two classes: condition precedent and condition subsequent.

Condition Precedent. When an estate does not arise until the happening of the contingency, it is on condition precedent. For example, a person grants a farm to another for five years, with a condition that the latter is to have an absolute estate upon the payment of $10,000 before the lapse of that period. Until the performance of the condition precedent, the grantee has only a possibility of an estate.[10] When the contingency happens, and the estate vests in the grantee, the estate is the same as though it were originally transferred without any condition.

Condition Subsequent. When the estate terminates upon the happening of a contingency, it is on condition subsequent. To illustrate, where a farm is granted to another provided he does not marry until he reaches majority, there is a contingency which will terminate the estate granted upon its happening.[11] A re-entry by the grantor or his heirs is necessary to terminate the estate after a breach of a condition subsequent. As courts do not favor conditions subsequent, they construe them to be covenants only, except when they are clearly expressed to be conditions. Conditions which are illegal or impossible to perform are void. When a condition is void, no estate arises if the condition is precedent, but the estate is absolute when the condition is subsequent. Conditions in restraint of marriage are frequently held to be void on the grounds that such conditions are contrary to public policy.

> One holding a fee upon condition subsequent "may sell and convey such fee." (Guilford v. Gardner, 180 Iowa 1210, 162 N. W. 261)

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[9] *Wheeler* v. *Walker*, 2 Conn. 196.
[10] *Johnson* v. *Warren*, 74 Mich. 491, 42 N. W. 74.
[11] *Shackelford* v. *Hall*, 19 Ill. 212.

On Limitation. An estate on limitation must be distinguished from an estate on condition subsequent. The former is a measure of the estate, whereas the latter is in the nature of a defeasance. If a person has an estate until he marries or while, or so long as, he is unmarried, he has an estate on limitation. If an estate is conveyed to him on condition that, or provided, he remains unmarried, he has an estate on condition subsequent. "In the case of a condition, the estate or thing is given absolutely without limitation, but the title is subject to be divested by the happening of an uncertain event. Where, on the contrary, the thing or estate is granted or given until an event shall have arrived, and not generally with a liability to be defeated by the happening of the event, the estate is said to be given or granted subject to limitation." [12] An estate on limitation terminates *ipso facto* upon the happening of the event, and no re-entry is necessary.

Equitable Estates. At early common law a practice was established of creating what is known as *uses*. A use existed when property was transferred to one person to hold for the use of another who was called the *cestui que use*. It originated in order to give corporations, ecclesiastical bodies in particular, the benefit of property which they were forbidden to hold by the terms of legislation known as the *mortmain acts*. The feoffee (transferee) to uses had the legal title; consequently the courts of law paid no attention to the cestui que use. The court of chancery, however, would enforce the beneficial interests of the cestui que use against the feoffee and all others, except against a bona fide purchaser without notice.

A use was ordinarily established by an express declaration by the feoffor, but in some instances it would be implied. When there was a conveyance without a consideration and no declaration of use, it was assumed that the feoffee was to hold the land for the benefit of the feoffor. This was known as a *resulting use*. A use was also implied by the chancellor when a bargain was made for the sale of land, and a consideration paid, but title was not transferred. In the eyes of equity, the vendor in such case held the land for the benefit of the vendee. Finally, equity would enforce a use when one person

[12] *Warner* v. *Bennett*, 31 Conn. 468.

"covenanted to stand seized" of the land to the use of his children or other blood relation.

Uses were employed for many purposes, some of which were considered undesirable. In order to stop such abuses, Parliament enacted the Statute of Uses.[13] This statute provided that upon a conveyance to one for the use of another, the cestui que use should by virtue of the statute immediately possess the legal as well as the equitable interest. This is still the law in many of our states as part of the common law or by legislation.

Uses of certain classes were not executed so as to give the cestui que use the legal estate, because of the construction placed by courts upon the statute. One class was that in which the feoffee was required to perform certain duties in connection with the use. Thus, when the feoffee to uses was to manage the property and turn over the profits, he retained the legal title.[14] Another class was that in which one held less than a freehold estate to the use of another, because the statute referred only to instances when one was seized to the use of another. For example, the statute did not apply when one held a term for years to the use of another, because it was possible to have seizin only in freehold estates.[15] A third class which the statute did not execute constituted cases of a use upon a use. To illustrate, when a conveyance was made to a person and his heirs to the use of a second person and his heirs to the use of a third person and his heirs, the second person would receive the legal title, but the statute would not operate to execute the second use in favor of the third person.[16] The court of equity would then enforce this second use as it had done before the statute.

> When one who holds property to the use of another is to collect rents and profits for the beneficiary, the statute does not operate to pass title to the beneficiary. (Lummus v. Davidson, 160 N. C. 484, 76 S. E. 474)

The use and its protection in equity is the origin of our modern trusts, whereby one person, called the *trustee*, holds

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[13] *Statute 27, Henry VIII*, ch. 10 (1535).
[14] *Upham* v. *Barney*, 15 N. H. 467.
[15] *Slevin* v. *Brown*, 32 Mo. 176.
[16] *Croxall* v. *Shererd*, 5 Wall. (U. S.) 268, 18 L. Ed. 572.

property for the benefit of another, called the *cestui que trust.* The relation between the trustee and the cestui que trust is highly fiduciary; consequently the former is held to strict accountability for his acts in respect to the trust fund or property. He is liable for negligence in handling the property, as well as lack of good faith or other wrongful acts amounting to a breach of trust. If he conveys the property wrongfully, it may be regained by the cestui que trust, if the transferee is not a bona fide purchaser without notice. Although the cestui que trust cannot convey the legal title, he may transfer his equitable interest, except possibly when the terms of the trust prohibit such alienation as in case of some "spendthrift" trusts.

Easements. One having a freehold interest in one piece of land may, in connection with it, have a freehold or lesser interest in the lands of another. Such interest is known as an *easement.* "An 'easement proper' is a privilege which the owner of one tenement has a right to enjoy in respect to that tenement in or over the tenement of another person." [17] Technically, it is only a privilege without profits from the land. There must be two distinct tenements—*a servient* tenement, which is subject to the easement, and a *dominant* tenement, to which the right is appurtenant. An easement cannot be separated from the dominant estate of which it is a part, and passes with the transfer of such estate. The most common form of easement today is that of a right of way over another's land. It may be general or special. In the former instance, the right of way is for all purposes, and in the latter it is limited to special purposes. For example, a right of way may exist for walking only, or merely for vehicles, or for the transportation of certain goods.[18]

In this country certain personal privileges whereby one is entitled to use the land of another are termed *easements in gross.* Such rights technically are not easements; they are in the nature of irrevocable licenses. An easement in gross is generally held to be neither assignable nor inheritable.

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[17] *Parsons* v. *Johnson,* 68 N. Y. 62.
[18] *Perry* v. *Snow,* 165 Mass. 23, 42 N. E. 117.

"An easement in gross is personal to the grantee, and is incapable of assignment." (Messenger v. Ritz, 345 Ill. 433, 178 N. E. 38)

An easement may be created in several ways. It may be expressly created by an agreement under seal by the owner of the servient estate, or by an exception or reservation in a deed by one conveying a parcel of land. An easement may be implied when one conveys part of his land which has been used as a dominant estate in relation to the part retained. To illustrate, if water or drain pipes run from the part alienated through the part retained, there is an implied right to have such use continued.[19] In order that an easement will be implied in such case, the use must be apparent, continuous, and necessary. The last requirement, however, is usually construed as meaning reasonably necessary. An easement may also be implied when it is necessary to the use of the land alienated. This ordinarily arises when one sells land to which no entry can be made, except over the land retained, or over the land of a stranger. The right to use the land retained for the purpose of going to and from the land is known as a *way of necessity*. In a very few cases an easement arises by estoppel, as where the grantor states that the plot conveyed is bounded by a street. If, in such case, the grantor owns the adjoining plot, he cannot deny the existence of such street. Finally, an easement may be created by prescription, a method which is discussed later.[20]

Profits a Prendre. One may also have a right in the land of another which amounts to more than a mere use without profit. He may be entitled to take the produce of the land or a part of the soil. This may involve the right of taking timber, fish, coal, or other minerals from the land. Such a right is known as a right of *profit a prendre*. The right involves more than an easement, although it is sometimes spoken of as such. Thus, in speaking of a right to catch and take fish in the waters on the land of another, a court said that "it is more than an easement; it is what is commonly called a profit a

[19] *Larson* v. *Peterson*, 53 N. J. Eq. 88, 30 A. 1094.
[20] *Post*, p. 746.

prendre, and it is of such a nature that a person who enjoys that right has such possessory rights that he can bring an action for trespass at common law for the infringement of those rights." [21]

A right of profit a prendre may be appurtenant to the land, as in the case of an easement, or it may be in gross. It is not necessary that there be a dominant estate for its existence. The right is generally held to be assignable and inheritable. It may be created in the same way as in the case of easements.

QUESTIONS

1. Castle declares that land includes all things of a permanent nature affixed to the ground. What is meant by this statement?

2. Harris builds his house so that the eaves extend over the land of his neighbor. Does he violate a right of the neighbor?

3. Wheary, while digging a cellar with tunnels running out therefrom in two directions, excavated beneath the surface of the land owned by his neighbor. Was a right of the neighbor violated?

4. White inherits a large estate including a house and several stables. He also inherits by custom the armor which is in the house. White contends that the house, stables, and armor are part of his land. Reddick contends that they are tenements. Do you agree with White or Reddick?

5. Watts transfers an estate for life to Sacman. Does the latter have a freehold estate of inheritance?

6. Emerson grants an estate to his son, John, for the life of the latter's wife. John decides to make a will and wishes to know whether he can dispose of this estate by a will. May he do so?

7. Lux conveys to his son the largest estate known to our law. What estate does the latter receive?

8. It is said that courts regarded estates in fee tail unfavorably. How do you account for this?

9. Steenburgh conveys to Mosley an interest in land known as a life estate. Does this estate descend to Mosley's heirs at his death?

10. Gilinger conveys to Rickie a city lot provided he does not use the property for manufacturing purposes. Does Rickie have an estate on condition precedent?

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[21] *Fitzgerald* v. *Fairbanks*, 2 Ch. Div., L. R. 1897.

11. A farm is granted to a widow so long as she does not marry. McCardell maintains that the widow has an estate on condition subsequent. Is his contention sound?

12. A piece of land is granted to Buschner provided he does not go abroad until he reaches majority. When sixteen years of age, he makes a trip to France. Is his estate ended?

13. Brewster transferred certain property to Tatum for the use of Durham. Were the rights of Durham enforceable at common law? in equity?

14. A tract of land was transferred by Wier to Arlen for the use of Ennis. How did the statute of uses affect the rights of Ennis?

15. Kerns transfers property to Campbell and his heirs for the use of Sutton and his heirs for the use of Bracton and his heirs. What are the rights of Campbell, Sutton, and Bracton in this property under these circumstances?

16. Perot is trustee of certain funds and property for the benefit of O'Shay. The former wrongfully transfers the property to Mather. What are O'Shay's rights?

17. Finch owns a farm bounded on the north by a street and on the other sides by land belonging to Wolcott. Finch transfers the south half of his farm to McKim. Does McKim have any rights in the land retained by Finch?

18. Richardson possesses the right to take certain ore from Tuft's land. Tuft, when attempting to sell this land, tells the prospective buyer of the encumbrances on it. Among other things, he mentions that Richardson has an easement. Is this statement correct?

Part III—Transferring Real Property [1]

Public Grant. Real property may be acquired directly from the government. The method of transfer in such case may be by legislative grant or by patent. A *patent* is ordinarily a document issued by the government to vest title in a transferee of land. It is not, however, issued in all cases as a conveyance. For example, title may have been vested in a transferee by virtue of a legislative grant, and a patent issued merely as evidence of title.[2]

In disposing of public lands, states have adopted various schemes. A usual method is to allow persons to enter upon land of a specified quantity, make certain improvements, occupy it for a specified period, till a certain portion, and sometimes make a payment of a nominal sum. When the requirements of the statute have been met, the government then issues a patent. This is the method commonly used by the federal government under the homestead laws.

A patent is in the form of a conveyance, and is effective when entered of public record. It is conclusive evidence at law as to title, except when issued without authority or when improperly executed. In equity, however, it is not conclusive as to other points affecting validity, except in the hands of a bona fide purchaser for value. To illustrate, when a patent has been secured by fraud, its validity may be questioned in equity by the one entitled to it or by the government.[3]

Feoffment. The common law method of transferring a freehold interest in land, or *seizin*, is known as *feoffment*.[4] The transferor is called the *feoffor*, and the transferee is known as the *feoffee*. Feeoffment involved a ceremony called *livery of seizin*. The ceremony consisted of either a livery in deed or a livery in law. In case of the former, the parties entered

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[1] Real property may also be transferred by judgment, by judicial and execution sales, by will, and by succession. These methods are discussed under Part V of this chapter.

[2] *Kernan* v. *Griffith*, 27 Calif. 89.

[3] *U. S.* v. *Marshall Silver Min. Co.*, 129 U. S. 579, 32 L. Ed. 734.

[4] Modern transfers by deeds, mortgages, and leases are discussed in Chapters XIII, XIV, and XV respectively. Transfers by bankruptcy are discussed in Chapter XVIII.

upon the land, and the feoffor formally transferred the seizin to the feoffee. At the same time he delivered a twig or part of the soil as a symbol of the seizin. In the latter case, the formal transfer was made in view of the land, after which the feoffee entered on the land. A written statement usually concluded the feoffment; it was later required by the terms of the Statute of Frauds. This method of transferring land is today generally of historical interest only, but occasionally it has some bearing on modern transfers.

Dedication. Any person possessing a legal or equitable interest in land may appropriate it to the use of the public. This is known as a *dedication.* There are two essentials to a valid common-law dedication. First, the real property must be set apart with the intention to surrender it to the use of the public. The intent may be express or implied. For example, where there is a subdivision of land into lots with parts set out apparently for streets, the intention to dedicate that part of the land to the public is implied.[5] Second, an acceptance is usually necessary on the part of the municipality or the state. This is important in some instances. To illustrate, if a street is dedicated, until acceptance thereof, there is no liability on the part of a city when the law requires that it maintain its streets in reasonably safe condition.[6] At common law a dedication gave the public an easement to use the property for the purposes set out, but it did not pass title. This feature and the requirement of acceptance have generally been changed by statutes.

Eminent Domain. The state has the inherent power to appropriate private property for public use. This power is known as the right of *eminent domain.* The term is also applied to the procedure involved in taking the property. Most states have statutes prescribing the procedure by which property is to be appropriated under this authority. There are federal and state constitutional limitations on the use of this power which require that payment of just compensation be made for land so taken.

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[5] *Waltman* v. *Rund*, 109 Ind. 366, 10 N. E. 117.
[6] *Town of Norman* v. *Teel*, 12 Okla. 69, 69 P. 791.

A state constitutional provision provides: "Private property shall not be taken or damaged for public use without just compensation having first been made." (Wolff v. City of Los Angeles, 49 Calif. A. 400, 193 P. 862)

There are two important questions involved in the transfer of property by this method; namely, whether there is a taking and whether it is for public use. In respect to the first, it is not necessary that one be physically deprived of his land. It is sufficient if he is denied the normal use of the property. To illustrate, when land is on a stream and the owner is deprived of access to the water, the land is to that extent appropriated.[7] In respect to the latter question, it is not necessary that the public actually use the land. It is sufficient that it is appropriated for a purpose which is for the public benefit. Thus property taken for governmental offices or public schools is taken for public use.[8]

Accretion. The owner of land acquires or loses title to land which is added or taken away by the action of water upon his property. An increase of land due to the action of water upon its borders is known as *accretion.* This gain or increase may result from *alluvion* or *dereliction.* Alluvion occurs where soil or sand is washed up by the waters and becomes attached to the land. Dereliction occurs where the waters recede, leaving bare land which was formerly a part of its bed. Thus, when the boundary line between two farms is the middle of a stream, any change in the course will add to the land on the one side and take away from the other land.[9]

In order that the owner of land may acquire title to land by accretion, it is necessary that the accumulation result from a gradual and imperceptible growth. In case of sudden and perceptible changes, the ownership of the land remains unaltered. To illustrate, if a river suddenly follows a different channel, the rights of the owners of the land formerly on each side thereof are not affected.[10]

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[7] *Pumpelly* v. *Green Bay & Miss. Canal Co.,* 13 Wall. (U. S.), 166, 20 L. Ed. 557.
[8] *Conn. College* v. *Calvert,* 87 Conn. 421, 88 A. 633.
[9] *Garrish* v. *Clough,* 48 N. H. 9.
[10] *Nebraska* v. *Iowa,* 143 U. S. 359, 36 L. Ed. 186.

Adverse Possession. Title to land may be acquired by holding it against the true owner for a certain period of time. In such case one gains title by *adverse possession.* In order to acquire title in this manner, possession must be (1) actual, (2) visible and notorious, (3) exclusive, (4) hostile, and (5) continuous for a required period of years.

What constitutes actual possession depends upon the nature of the land. For example, it may be that residence thereon, cultivation without residence, or possibly mere fencing of the land will be sufficient.[11] One may hold adversely land not actually in possession, when the claim is based upon an invalid conveyance. This is known as *color of title,* and the claimant is considered as having constructive possession of the land therein described. Visible and notorious possession means holding the land in such manner that the owner could by reasonable inspection discover the adverse claim. Exclusive possession means that the holding must be exclusive of third persons as well as the owner. Hostile possession means that there is a holding under a claim inconsistent with the rights of the owner. For example, the possession of a tenant under a lease is not hostile to the landlord; hence it cannot ripen into an adverse title.[12] Continuous possession means possession without interruption by voluntary abandonment or by an act of the owner.

> "We have held . . . that, if there was a break in the occupancy for the requisite time so as to destroy its continuity, there would be no ripening of title, and that the beginning of a new tenancy would commence after such break or breaks." (Mounce v. Hargis, 211 Ky. 761, 278 S. W. 107)

The period during which land must be held adversely in order to gain title varies in the different states. In many states the statute prescribes twenty years, whereas in others the period is less. If an adverse claimant holds for a part of the prescribed period and is immediately succeeded by another, the latter cannot count the time of possession by the former in computing the duration of adverse holding, unless there is

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[11] *Brumagin* v. *Bradshaw,* 39 Calif. 24, 177 P. 885.
[12] *Rigg* v. *Cook,* 9 Ill. 336.

privity between them. For example, the time of possession by the first claimant may be added to the second claimant's time, if the latter is a transferee or an heir of the former.[13]

The right to use another's land for some purpose, as in the case of an easement, may be acquired by adverse use. This is known as *prescription*. The elements requisite to the acquiring of rights by prescription are practically the same as in adverse possession, except that the use need not be exclusive of others.

By Marriage. At common law, interests in both real and personal property may be acquired by marriage. All the personal property of a wife, except certain interests in land and rights to money or things, are vested absolutely in her husband upon marriage. In respect to her rights to obtain money or things, he acquires such things or money only upon obtaining possession thereof. Her personal property, consisting of certain interests in land, is acquired by the husband, but he can dispose of them only during his life unless he survives his wife, in which case he acquires absolute ownership in them. Statutes today very generally allow the wife to have separate real and personal property free from control of the husband.

> A woman's property upon marriage "shall continue to be her separate property, notwithstanding such marriage." (Mason's Minnesota Statutes, 1927, ch. 72, Sec. 8617)

Curtesy. At common law the husband acquires upon marriage an estate for life in the inheritable real property of which the wife is seized during marriage, provided issue capable of inheriting is born alive. It is held by a number of courts of law that the right to acquire this interest is an incident to all states of inheritance, and it cannot be excluded by the terms of the conveyance to the wife. Courts of equity, however, have been inclined to accept a contrary view. To illustrate, they have held that the husband does not acquire an interest in the wife's land when the conveyance prescribed that it was for her benefit only.[14] Modern statutes have abolished or modified the common-law doctrine of curtesy.

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[13] *Fugate* v. *Pierce*, 49 Mo. 441.
[14] *Deming* v. *Miles*, 35 Nebr. 739, 53 N. W. 665.

Dower. At common law the wife acquires by marriage the right to an estate for life upon the death of the husband in one third of the inheritable real property of which he was seized during marriage. If the husband made a provision for his wife in his will, it is usually held that she does not acquire a dower interest when she elects to take under the provisions of the will. Under some statutes there is a presumption of election to take under the will, unless there is a renunciation within a certain period. The common-law right of dower has been changed in many states. To illustrate, the wife in some states is given one half of the husband's estate when there are no children. In the other states different methods of distribution have been substituted for the right of dower.[15]

QUESTIONS

1. Brent tells Dailey that he intends to acquire from the government a certain portion of the public lands. Dailey states that the only mode of transferring public lands is by patent. Has Brent been correctly informed?

2. Lockwood wished to transfer a freehold interest in land at early common law. How did he do so?

3. Gilpin has for many years been a prosperous businessman in a certain city. He possesses a large tract of land within the limits of the municipality, which he wishes to appropriate to the use of the public as a park. How can he do this?

4. A state institutes proceedings to take Dowell's land for the purpose of constructing an armory. The latter claims that the government has no right to take his property for this purpose. Is his contention sound?

5. The government starts a training school in gas warfare on land adjoining Turton's property. Because of the fumes coming from the school, Turton is unable to use a portion of his land. He maintains that he is entitled to just compensation for the portion of his land which he cannot use. Is he entitled to this compensation?

6. Tinley and Gregor own large ranches which are separated by a river. One night the river suddenly follows a different channel and runs through the latter's land at a point one mile from its original bed. Tinley now claims the land between the old and the new channels. Is his claim well founded?

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[15] *Lake* v. *Bender*, 18 Nev. 361, 7 P. 74.

7. Runkle leases his land to Winemiller for ten years. After a period of five years, Winemiller refuses to pay rent, claiming the property as his own. Ten years later, Runkle brings suit to oust Winemiller from the land. The latter claims title for adverse possession. If the statutory period necessary to acquire adverse title is fifteen years, is Runkle entitled to eject Winemiller?

8. Acres holds certain land adversely for a period of ten years. After his death, the land is held for an additional ten years by his only son who now claims title. If the statutory period for title by adverse holding is twenty years, is his claim valid?

9. McFarland executes a will in which he gives to his wife one fifth of his real property which is owned in fee simple. After his death, what are the rights of his wife in this property?

10. In January, 1890, Powell, without permission, starts to drive across Streshly's land in order to shorten his trip to the city. In 1925, Hingham starts to use the land in the same way. Both continue to drive over this strip of land until 1930 when Streshly erects a barrier to prevent anyone from going over the land. May Streshly restrain Powell and Hingham from going over his property?

11. A bride possesses personal property in the form of an automobile, a promissory note, and a leasehold estate. What are the common-law rights of her husband in each?

12. A wife during marriage becomes owner of a farm in fee simple. Upon her death the husband maintains that he is entitled at common law to an estate for life in this land. Is his contention sound?

Part IV—Personal Property

Chattels Real. All rights that one has in things, movable or immovable, not amounting to real property are called *personal property.* These rights are also known as chattel interests. The term *chattel* is more comprehensive than the word *goods,* which is ordinarily confined to movable things.

Personal property or chattels may be divided into two classes, *chattels real* and *chattels personal.* Chattels real are interests in things real or real estate, which are less than a freehold. For example, an estate at will, an estate from year to year, or an estate for years is a form of personal property known as a chattel real.[1] A lease for five hundred years is regarded as personal property; but a life estate, being a freehold interest, is considered real property.

> A lease "is treated as a chattel real, falling within the classification of personal property." (Waddell v. United Cigar Stores of America, 195 N. C. 434, 142 S. E. 585)

The term *chattels real* originated because of the fact that the interests described concern and savor of realty (a quality of which they possess, immobility) but lack the element of indefinite duration. Because of the latter fact, a chattel real is not "equal in the eyes of the law to the lowest estate of freehold, a lease for another's life." It is said to be a kind of property "of a mongrel, amphibious nature, originally endowed with only one of the characteristics of each species of things; the immobility of things real and the precarious duration of things personal." [2]

Chattels Personal Corporeal. Chattels personal, as distinguished from chattels real, are interests one has in things movable. In other words, they are things which "may be carried about the person of the owner wherever he pleases to go." The fact that the things are large or cumbersome, or in some instances attached to the soil, does not affect the classification. Thus, "growing trees, when they are the subject of an ownership distinct from the ownership of the soil, are no longer deemed as annexed to the realty, but are regarded as entirely

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[1] *Hyatt* v. *Vincennes Nat. Bank,* 113 U. S. 408, 28 L. Ed. 1009.
[2] 2 *Blackstone Comm.,* p. 388.

abstracted or divided therefrom. They are regarded as chattels personal merely; like growing crops of grain and vegetables, which are the annual produce of labor, and of the cultivation of the earth." [3]

> A two-room house was considered personalty under the general rule that, when "a dwelling-house is sold with the understanding that such house is to be removed from plaintiff's land, the dwelling-house thereby becomes personal property." (Bourret v. Lewmaster, 121 Nebr. 815, 238 N. W. 739)

Chattels personal may be divided into two classes, tangible and intangible. The former are known as *chattels personal corporeal.* This class of personal property embraces ownership in material things which may be seen and handled. Illustrations of personal property of this kind are animals, wheat, jewels, garments, and furniture.[4] These articles are also called *choses in possession,* or things in possession.

Chattels Personal Incorporeal. Personal property not only includes rights in a thing in possession, but also a right to receive chattels personal not in possession. Such rights or the objects of such rights are called *choses in action.* They constitute a form of personal property known as *chattels personal incorporeal.*

> "A 'chose in action' has been defined to be 'a right to personal things of which the owner has not possession, but merely a right of action for their possession.'" (Spears v. West Coast Builders' Supply Co., 101 Fla. 980, 133 S. 97)

Choses in action include all rights of action, whether *ex contractu* or *ex delicto.* "While a chose in action is ordinarily understood as a right of action for money arising under contract, the term is undoubtedly of much broader significance, and includes the right to recover pecuniary damages for a wrong inflicted upon the person or property. It embraces demands arising out of a tort, as well as causes of action originating in the breach of a contract." [5] It has been held, how-

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[3] *Warren* v. *Leland,* 2 Barb. (N. Y.) 613.
[4] *Atl. Safe Dep. Co.* v. *Atl. City Laundry Co.,* 64 N. J. Eq. 140, 53 A. 212.
[5] *Cincinnati* v. *Hofer,* 49 Ohio St. 60, 30 N. E. 197.

ever, in the construction of some statutes that the term *chose in action* does not include rights arising out of torts. In such cases it depends upon the intention of the legislature whether the term is to include all rights of action, only assignable rights of action based upon either contract or tort, or only rights of action arising out of contract. Some common forms of choses in action are insurance policies, stock certificates, bills of lading, and any "evidence of indebtedness, under whatever name it may be termed, whether note, bond, bill of exchange or other instrument, and however secured." [6]

Fixtures. In some instances movable chattels may lose their nature of personal property and become a part of real property. This occurs when such chattels are annexed or affixed to the land. They are then known as *fixtures.*

There is considerable conflict in authority as to what constitutes a fixture. The parties may agree that chattels affixed to land are or are not to retain their character of personal property. In the absence of agreement, however, it is frequently a difficult question to solve. Courts take into consideration whether the article has been actually or constructively annexed to the realty, and what was the intention of the annexor as to its permanence. Thus, "blocks of stone placed one on the top of another without any mortar or cement, for the purpose of forming a dry stone wall would become a part of the land, although the same stones, if deposited in the builder's yard and, for convenience' sake, stacked on the top of each other in the form of a wall, would remain chattels." [7]

> "A bed ordinarily is not part of the realty, though it may be such by permanently attaching it to the realty as by building it into the wall so that it would be immovable and its destruction would result in injury to the realty." (Fisher v. Pennington, 116 Calif. A. 248, 2 P. [2d] 518)

The practice of business of moving chattels upon leased premises has caused modern courts to scan the adaptability or necessity of the chattels to the use of the land and the purpose of the annexation. Thus it has been stated that "the united application of the following requisites will be

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[6] *Easton* v. *Peoria,* 183 Ill. 255, 55 N. E. 716.
[7] *Holland* v. *Hodgson,* L. R. 7 C. P. 328.

found the safest criterion of a fixture: (1) actual annexation to the realty, or something appurtenant thereto; (2) appropriation to the use or purpose of that part of the realty with which it is connected; (3) the intention of the party making the annexation to make the article a permanent accession to the freehold—this intention being inferred from the nature of the article affixed, the relation and situation of the party making the annexation, the structure and mode of annexation, and the purpose or use for which the annexation has been made." [8]

Severed Realty. The character of property may not only be changed from personal to real property, as indicated above, but may also be changed from real to personal property. When the materials of a house or other building on the land, such as bricks or boards, or the rails of a fence, are removed, they assume the character of personal property. The same is true when things that are imbedded in or beneath the soil are taken up and removed. Thus, when stones are removed from the earth and sold, they become personal property.[9]

> With reference to dismantled machinery taken by the holder of a real property mortgage, the court said: "Even if the things seized had once been attached to the realty and formed part thereof, nevertheless, having been detached, they have now lost their character of immovables." (Wakefield State Bank v. T. Fitzwilliams & Co., 158 La. 838, 104 S. 734)

It has been held that one must have the authority and the intention in order that the character of the property be changed by severance. This rule has not been applied, however, in the case of trees, for it is usually held that a severance thereof, even by a trespasser, changes the character of the trees from real to personal property. It is also established that in some instances the severance need not be actual, but may be constructive. To illustrate, when the owner of land sells certain timber in contemplation of immediate felling and removal, there is a constructive severance which changes the form of the timber from real to personal property.[10] There is

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[8] *Teaff* v. *Hewitt*, 1 Ohio St. 511.
[9] *Fulton* v. *Norton*, 64 Me. 410.
[10] *Tilford* v. *Dotson*, 106 Ky. 755, 51 S. W. 583.

also a constructive severance when the owner conveys the land but reserves the right to the timber thereon.

QUESTIONS

1. Kingsley possesses the following: (a) an estate from year to year, (b) a fee-simple estate, and (c) a one-third interest in a radio. Which of these interests, if any, are known as personal property?

2. Parker leases Green's land for a period of ten years. Later the former purchases a half interest in the latter's tractor. Are the interests of Parker chattels real or chattels personal?

3. Wilkins has an estate in a given parcel of land for the life of another person and a lease on other property for two hundred years. Which is regarded as the greater interest?

4. Pondor has the following items of property: a watch, an overcoat, an automobile, an insurance policy, a bond, a bill of lading, a typewriter, a promissory note, and a stock certificate. Which of these are choses in action?

5. Wellington contends that the interest one has in an automobile is known as a chattel personal incorporeal. Do you agree with him?

6. Hinson plants and cultivates a crop of tomatoes in his garden. Are these vegetables before severance considered real property?

7. Parkside lines his well with bricks and deposits the surplus in his garage. Are the bricks used in the well and the surplus bricks real or personal property?

8. Perlstein leases a piece of land to be used for manufacturing purposes. He moves upon the premises several large machines which, to be used, must be set in cement embedded in the soil. When Perlstein's lease expires, the owner of the land refuses to allow him to remove the machines on the ground that they are now part of the realty. Is the action of the landlord justified?

9. Kenard operates a stone quarry. What is the character of the stone in terms of property, before and after being quarried?

10. Regal conveys his farm to Lisson but reserves the right to the timber on the premises. Is the character of the timber real property?

Part V—Acquiring and Transferring Personalty [1]

Occupation. No one has a right or interest in wild animals or fowls so long as they are in the state of nature. One may acquire property in such animals or fowls in two ways. First, he may become the absolute owner of such which he kills. If two or more persons are engaged in a chase, the animal belongs to the one who so wounds or ensnares the animal that escape is impossible, provided he does not abandon pursuit.

> "If animals are wrongfully killed on the land of another, they become the property, it seems, of the landowner." (Sewers v. Hacklander, 219 Mich. 143, 188 N. W. 547)

Second, one may acquire a qualified right in wild animals or fowls by capturing and confining them, or by capturing and making them tame. The property in wild animals or fowls that have been tamed or maintained in captivity is lost if they escape and return to their natural liberty. The property is not lost, however, when an animal or fowl leaves but intends to return, as in the case of pigeons, or when the escaping animal is promptly pursued and can be identified. What constitutes a return to the natural state is a question about which there is a conflict in authority. Temporary escape is usually held insufficient to deprive the captor of his property. Thus one court states, "To say that if one has a canary bird, mocking bird, parrot, or any other bird so kept, and it should accidentally escape from its cage to the street, or to a neighboring house, that the first person who caught it would be its owner, is wholly at variance with our views of right and justice." [2]

Property may also be acquired by taking possession of things abandoned by another. When property has been abandoned, the title is lost thereby and may be acquired by the first possessor or finder. Abandonment consists of the intention on the part of the owner to abandon his rights and of

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[1] Personalty may also be transferred by adverse possession, marriage, and bankruptcy. See Part III of this chapter. Transfers by bankruptcy are discussed in Chapter XVIII.

[2] *Manning* v. *Mitcherson*, 69 Ga. 447.

an actual relinquishment of the property. "Property is said to be abandoned when it is thrown away, or its possession is voluntary forsaken by the owner." [3]

> Mine tailings, having been abandoned, could be appropriated by anyone, provided they had not been reclaimed before such appropriation. (Fidelity-Philadelphia Trust Co. v. Lehigh Valley Coal Co., 294 Pa. 47, 143 A. 474)

Abandonment differs from other transfers, such as gifts or sales, in that in the former case the owner relinquishes his rights with indifference as to what party may subsequently acquire and appropriate them. Losing property must also be distinguished from abandonment. In the first instance, there is no intent to part with the property, whereas in the second case there is. The effect of taking possession of the property is therefore quite different in the latter situation. "In the one case the finder has the right to possession against all but the true owner. In the other he acquires absolute property by right of his occupancy." [4]

Accession. Property may be acquired by means of an addition to or an increase of things which one owns. This is known as *accession.* It is an ancient doctrine which gives to a person all that is produced from his property or added to it. The application of this rule is simple in case of produce of land or the young of animals, but it is frequently difficult where the goods of one person have been added to another's or where the labor and skill of one transforms the property of another.

> When two tires were placed on an automobile without title thereto being retained, "under the doctrine of accession, they became part of the car." (Diamond Service Station v. Broadway Motor Co., 158 Tenn. 258, 12 S. W. [2d] 705)

As a general rule, repairs become a part of the article being repaired. "When the owner of a damaged or worn-out article delivers it to another person to be repaired and renovated by the labor and materials of the latter, the property in the article, as thus repaired and improved, is all along in the original owner for whom the repairs were made, and not

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[3] *Eads* v. *Braselton*, 22 Ark. 499.
[4] *Ferguson* v. *Ray*, 44 Oreg. 557, 77 P. 600.

in the person making them." [5] Likewise, when materials are furnished to another to be manufactured into an article, title to the finished article is in the owner of the materials. If the manufacturer, however, adds a larger proportion of the materials, title will then usually vest in him.

A more difficult problem arises when changes in property are made against the wishes or at least without the consent of the owner. In such case the gaining of property by accession depends upon whether the act was done intentionally and willfully or unintentionally and innocently. In the former case, regardless of the degree of change, the trespasser cannot acquire title by accession. In case of honest mistake, the trespasser may in some cases, but not in all, acquire title in this way. In some instances the courts allow the innocent trespasser to acquire title when, by his labor and skill, he has greatly increased the value of the goods, but not when a slight increase in value occurs. To illustrate, when timber worth $25 was changed into hoops worth $700, the trespasser was given title.[6] In other instances the courts determine whether title has passed by accession on the basis of whether or not the labor and materials of the trespasser have changed the property into a different specie. For example, when an innocent trespasser takes timber of another and constructs a home or a boat, there is a change in specie sufficient to vest title to the timber in the trespasser.[7] This test does not consider the original and later relative value of the goods, but its difficulty is in determining whether there is a change in specie.

Another test frequently used is that title does not change by accession when the form or value of the goods has been changed, so long as there is no loss of identity. "It was a principle settled as early as the time of the Year Books, that, whatever alteration of form any property had undergone, the owner might seize it in its new shape and be entitled to the ownership of it in its state of improvement if he could prove the identity of the original materials." [8] Under this rule there is difficulty in determining when the identity

[5] *Gregory* v. *Stryker*, 2 Den. (N. Y.) 628.
[6] *Potter* v. *Mardre*, 74 N. C. 36.
[7] *Wetherbee* v. *Green*, 22 Mich. 311.
[8] *Eaton* v. *Monroe*, 52 Me. 63.

of the goods has been changed. When timber is made into shingles, fence posts, and boards, it has been held that the identity has not been lost, but that it has when used to build a house. In all cases it seems that in applying the rule, courts are seeking a result which will give substantial justice to the parties under the particular circumstances.

Intellectual Productions. One may acquire property by intellectual labor and production. A right to intellectual productions is given by the common law independent of statute. "At common law the author of a literary composition had an absolute property right in his production which he could not be deprived of so long as it remained unpublished, nor could he be compelled to publish it. This right of property exists at common law in all productions of literature, the drama, music, art, etc." [9] The right to intellectual production exists in respect to expressed ideas whether or not they are entirely original, new, or meritorious, so long as they are the result of independent mental labor. For example, one has a common-law property right in a collection of informational data, facts, or items, although they are commonly known and can be secured by others.[10]

> "The basic principle on which the right of the author is sustained even as to writings confessedly literature is not their literary quality, but the fact that they are the product of labor." (Baker v. Libbie, 210 Mass. 599, 97 N. E. 109)

The right to intellectual productions is extended by statute. Congress under authority of the Constitution has enacted legislation to this effect. In order to further the sciences and arts, one is given a right in things resulting from mental labor which is expressed in the form of literature, works of art, and inventions. These rights are commonly known as copyrights and patent rights. A *copyright* is a grant to authors giving them the exclusive right to possess, make, publish, and sell copies of their intellectual productions, or to authorize others to do so, for a period of twenty-eight

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[9] *Frohman* v. *Ferris*, 238 Ill. 430, 87 N. E. 327.
[10] *Chicago Bd. of Trade* v. *Christie Grain, etc., Co.*, 198 U. S. 236, 49 L. Ed. 1031.

years, with the privilege of a renewal and extension for an additional term of twenty-eight years. A copyright may be secured for addresses, books, maps, musical compositions, motion pictures, and similar productions, provided the work is an original expression of the idea, and not seditious, libelous, immoral, or blasphemous. A *patent* is a grant to one who has given physical expression to an idea, giving him the exclusive right to make, use, and sell, and to authorize others to make, use, and sell the invention for a period of seventeen years. The invention must be a new and useful art, machine, or composition of matter not previously known and used.

> The approach-forcing system of contract bridge "is an idea, property in which can be secured neither by copyright, which protects only means of its expression, nor by patent, which would protect only the means of reducing it to practice." (Downes v. Culbertson, 242 App. Div. 853, 275 N. Y. S. 232)

Statutory rights in intellectual productions are distinct and separate from common-law rights. The common-law right in the production of a drama, for example, exists only until its publication, whereas the statutory right is in the production after its publication. The latter right begins where the former right ends. Another difference is that the common-law right is perpetual, whereas the statutory right is of limited duration.

Judgments. As a general rule a judgment in favor of one person against another does not affect the title of the latter's property. In many states judgments create liens upon the real estate of the judgment debtor by virtue of statutes. In such a case, however, title can be acquired only by subsequent proceedings. In some instances a judgment will transfer title to property. For example, when one person misuses the goods of another who sues for the value thereof, alleging conversion, a judgment for the plaintiff will by operation of law vest the title in the converter.[11] Judgments declaring a forfeiture or confiscation of goods may be the penalty for violating certain laws, as in the case of an attempted evasion of the revenue laws.

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[11] *May* v. *Georger*, 21 Misc. Rep. 622, 47 N. Y. S. 1057.

By statute "a judgment is a general lien upon all debtor's real estate, except homestead exemption." (Ex parte Johnson, 147 S. C. 259, 145 S. E. 113)

The class of judgments by which one ordinarily acquires or loses property is known as judgments *in rem*. A judgment in rem is a judgment which declares the status of the title and the right of possession of the property. In such a case the judgment "is a solemn declaration upon the status of the things, and it (the judgment) ipso facto renders it what it (the judgment) declares it to be." [12] No other proceedings or decree is necessary in order to settle the matter. Judgments of this nature are allowed only when the property is within the jurisdiction of the court and when proceedings have been brought against the property in controversy. Title to property gained by judgment of a court of competent jurisdiction is the best title obtainable. It is conclusive against all the world and is subject only to a direct attack on grounds of irregularity or fraud.

Judicial and Execution Sales. Property may be acquired by means of involuntary sales of two classes, judicial sales and execution sales. A *judicial sale* is one which is made by a proper person upon an express order and under the direction of a court having jurisdiction of the subject matter. Such sales are "in theory made by the court itself, though acting through an officer appointed for the purpose, who reports his doings to the court." [13] Examples of judicial sales are sales made by receivers, executors, administrators, guardians, trustees in bankruptcy, and sales for taxes. The distinguishing characteristics of such sales are that they must be made by a decree of court under its general authority, rather than by authority under a statute or agreement, and they must be confirmed. For example, where an executor makes a sale by authority of the terms of a will or by the terms of a statute, it is not a judicial sale.[14]

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[12] *Woodruff* v. *Taylor*, 20 Vt. 65.
[13] *Smith* v. *Pacific Heights R. R. Co.*, 17 Hawaii 96.
[14] *Barth* v. *Fidelity Trust Co.*, 188 Ky. 788, 224 S. W. 351.

> "In the matter of judicial sales, it is well settled that the court assumes the character of a vendor, even though his orders may be carried out through a receiver." (Bulloch v. Fisher, 26 F. [2d] 537)

An *execution sale* is such as is made by the sheriff or another officer to enforce a judgment for money that has been obtained. Statutes may and do authorize such sales for other obligations. Sales of this kind include three steps, the execution, the levy, and the sale. A writ of execution is frequently defined as a "process authorizing the seizure and appropriation of the property of the defendant for the satisfaction of a judgment against him." [15] The execution is served by notifying the debtor of its contents and demanding satisfaction. The next step in the proceedings is for the officer to whom the writ of execution is addressed, to appropriate all or a part of the property of the judgment debtor. The act of appropriation is known as the levy of an execution. The third step is the sale. An execution sale, in order to give the buyer a valid title, must follow a valid execution and a valid levy, must be made in conformity with statutory requirements, and must be regular in other respects.

Confusion. Personal property may be acquired when the property of two persons becomes intermingled under such circumstances that one owner forfeits his right in the goods. This is known as the doctrine of *confusion of goods*. Under this rule "all the authorities agree that if a man willfully and wrongfully mixes his own goods with those of another owner, so as to render them undistinguishable, he will not be entitled to his proportion, or any part, of the property. Certainly not, unless the goods of both owners are of the same quality and value. Such intermixture is a fraud. And so, if the wrongdoer confounds his goods with goods which he suspects may belong to another, and does this with intent to mislead or deceive that other and embarrass him in obtaining his right, the effect must be the same." [16]

In many instances when a mixture of goods occurs, the doctrine of confusion does not apply. When the mixture is by

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[15] *Lombert* v. *Powers*, 36 Iowa 18.
[16] *Hentz* v. *The Idaho*, 93 U. S. 575, 23 L. Ed. 978.

consent of the parties, neither loses his rights. If the mixture is made by one without fraudulent intent, as by accident or mistake, his rights are protected as far as possible. Nor does the rule apply when the goods are capable of identification. For example, when one mixes his cattle with those of another, even though willfully, he does not lose title to his cattle, if they may be readily identified.[17] Another instance in which the rule does not apply is when the goods that have been mixed are of equal kind and grade, although not capable of being distinguished, as in the case of articles such as oil, tea, and wheat. In this case each is entitled to his proportionate share of the mixture.

Will and Testament. Property may be acquired by means of a will. A *will* is a declaration of a person, in the manner prescribed by law, whereby he prescribes the disposition of his property after death. The power and right to dispose of personal property by will was granted by common law, but the power to dispose of real property did not exist until the Statute of Wills.[18] The right to dispose of property, real or personal, by will now depends entirely upon statutes.

The person who makes a will is called the *testator,* if a man, and a *testatrix,* if a woman. A gift of personal property by will is called a *bequest* or a *legacy,* and the person to whom it is given is known as the *legatee.* A gift of interests in land is called a *devise,* and the recipient of such a gift is known as the *devisee.*

It sometimes happens that the testator wishes to change his will in some manner but does not desire to make an entirely new will. This is done by means of an addition known as a *codicil.* A codicil is a declaration in legal form subsequent to the will and constituting a part of the will. It may add, qualify, or revoke all or any of the provisions contained in the original instrument.

> A codicil "is a supplement to a last will and testament, and it must be executed with the same legal formalities of a will." (Foye v. Foye, 35 Ohio A. 283, 172 N. E. 386)

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[17] *McKnight* v. *U. S.,* 130 F. 659.
[18] *St. 32, Henry VIII,* ch. 1.

Who may make a will, the manner of making it in order to be valid, and who may take property, depend upon the provisions of the statutes in the different states. A will disposing of personal property, regardless of its location, is ordinarily governed by the laws of the state wherein the testator was domiciled at the time of his death. This is based upon the theory that personal property accompanies the owner wherever he goes. On the other hand, a will disposing of real property is ordinarily governed by the laws of the state in which the property is located, regardless of the domicile of the testator. To illustrate, when a testator domiciled in California has personal property in Florida and real property in Rhode Island, the laws of California govern the validity of the will in respect to the disposal of the personal property, while the laws of Rhode Island govern the validity of the will in so far as it disposes of the real property.[19]

> Holographic wills, that is, wills entirely written, dated, and signed by the hand of the testator, are allowed in some states, although a few states also require the instrument to be found among the valuable and personal effects of the deceased. (In re Groce's Will, 196 N. C. 373, 145 S. E. 689)

The disposal of property by will must be in exact compliance with the law. The statutes are, as a general rule, strictly construed to prevent fraud. The usual requirements of the statutes are that the testator be of a prescribed age, and of sound and deposing memory; that the will must be in writing; that it must be signed or subscribed by the testator and acknowledged before witnesses; and that the latter must attest the fact that the instrument has been signed, published, and acknowledged as the will of the testator. These requirements, however, are not uniform. For example, the number of witnesses may vary; some states may only require the signing or acknowledgment thereof before the prescribed number of witnesses, whereas others require the witnesses to attest the signature of the testator in his presence and in the presence of each other.[20]

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[19] *Atkinson* v. *Staigg*, 13 R. I. 725.
[20] *Roberts* v. *Welch*, 46 Vt. 164.

Succession. One may acquire both real and personal property by succession. *Title by succession* means the rights and interests one acquires as a matter of law in the property of a deceased ancestor who dies intestate, or, in other words, without making a will. The term *succession* covers the acquisition of property by descent as well as by distribution. *Descent* technically means the transmission of title of the real property of a deceased owner by operation of law to his heirs. *Distribution* refers to the division of the personal property of the deceased owner by the personal representative among the heirs.

The parties to whom property passes upon the death of an intestate owner are now entirely governed by statutes which vary in many details in the different states. Who may receive personal property by succession is governed by the laws of the state in which the intestate was domiciled, irrespective of the location of the property. On the other hand, it is firmly settled that descent is governed by the laws of the state in which the property is located, irrespective of the intestate's domicile. Thus it has been stated that "the unquestioned right of a state to prescribe the manner in which real estate within its boundary may descend must not be lost sight of. This right should be guarded, and in a doubtful case of conflict of laws should be resolved in favor of the state where the property is located." [21]

Gifts. Property may also be acquired by way of a gift. When property is voluntarily transferred from one to another gratuitously, the transaction is known as a *gift.* A gift of personal property may be one of two kinds, gifts *inter vivos* and gifts *causa mortis.*

Inter Vivos: This form of gift is one which is absolute and complete, the title to the property vesting in the transferee. It is essential that the donor voluntarily intend to divest himself of the property absolutely, that the property be delivered, and that it be accepted. An acceptance, however, is presumed when the gift is beneficial to the donee, in the absence of a refusal. The delivery may be actual or con-

[21] *Cole* v. *Taylor,* 132 Tenn. 92, 177 S. W. 61.

structive. To illustrate, if the donor makes a gift of the contents of a safety deposit box or other receptacle, and if he delivers the key thereof to the donee, there is a constructive delivery sufficient to constitute a gift.[22]

Causa Mortis. This form of gift is conditional although absolute in form. It exists when the donor, in contemplation of death, delivers personal property to the donee to keep absolutely in the event of the donor's death. One important element of this form of gift is that it must be made in contemplation of death due to an existing illness or proximate impending peril. Another element of a gift causa mortis is that it is "subject to the following implied conditions subsequent, attached by law, the occurring of any one of which will operate a defeasance of such gift: first, if the contemplated danger of death passes by without the donor dying; second, if the donor should think it proper to revoke the gift before his death; or third, if the donee should die before the donor." [23]

QUESTIONS

1. Koretz captured a wolf and confined it in a pen on his land. Baker took the animal, claiming that it was wild and that he had as much right to it as Koretz. Was he right?

2. A fox which had been captured by Rankin escaped. While Rankin was pursuing it, the animal was caught by Vosch, who then claimed title to it. To whom did the animal belong?

3. Barnard and his family were having a picnic supper in a forest preserve. While there, Barnard changed a tire on his automobile. A small wrench was left on the ground when they drove home. Rankin found the tool and claimed it as his own. Was he entitled to it?

4. Tyler took some fancy buttons to a tailor, requesting that they be used on an overcoat which he ordered made for him. Who owned the coat when it was finished?

5. Krueger, who was domiciled in the state of Oklahoma, died without leaving a will. At the time of his death he owned a farm that was located in Kansas and an automobile that was stored in a warehouse in Texas. What law governed the descent and the distribution of this property?

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[22] *Yancy* v. *Field*, 85 Va. 756, 8 S. E. 721.
[23] *Seabright* v. *Seabright*, 28 W. Va. 412.

6. Crane willfully takes timber belonging to Bowen and makes a boat. Bowen claims the boat. Is his claim valid?

7. Townsend compiles the following information: the location and nature of the stores in a given city. He does not publish this material and does not secure a copyright. Bass maintains that he is entitled to use this collection of facts without Townsend's permission. Is his contention sound?

8. Jenkins wishes to secure a copyright for a book which he has written. Under what conditions may he do so?

9. Leiter and Tesner, who live in Missouri, are engaged in a controversy over the title of a parcel of land located in Iowa. The former suggests that the latter bring an action against him in a Missouri court for the purpose of settling a question of title. Tesner contends that this is not the proper procedure. Do you agree with him?

10. "Title to property gained by judgment of a court of competent jurisdiction is the best title obtainable." What is meant by this statement?

11. A warehouseman under statutory authority sells unclaimed goods for storage charges. Is this a judicial sale?

12. Morrison sues Hepler for damages arising out of breach of contract and receives judgment for $2,500. How can Morrison satisfy the judgment?

13. Gaylord mixes his coal with some belonging to Wren. If the coal of each is of the same grade and quality, does Gaylord forfeit his rights?

14. The property of two persons is mixed by the actions of a flood. If it is impossible to identify the property of either, what are the rights of the parties?

15. Williams dies leaving a will. His domicile was in California, and he had stocks and bonds in a safety deposit box in Chicago and two pieces of land in Michigan. What law governs the validity of the will in respect to such property?

16. Ransom, being seriously ill and thinking that he was near death, gave his watch to Leake. While he was convalescing, Ransom was accidentally crushed to death by an automobile. His executor claimed the watch, and Leake refused to give it up. Is the latter entitled to keep the watch?

17. Wickins acknowledges his signature to a will to three witnesses but at different times. If three witnesses only are required by law, is the will properly attested?

CASES FOR REVIEW

1. Cedric Duff, a minor, owned certain land in Okmulgee, Oklahoma. His guardian, Harwood Keaton, with the permission of the court, entered into an agreement whereby he leased the land for oil and gas mining to the Prairie Oil & Gas Company, a Kansas corporation. In an action brought by Duff through his mother, Evaline Duff, against Keaton and others for the purpose of avoiding the transaction, a question arose as to how a lease should be classified as property. What is your opinion? (Duff v. Keaton, 33 Okla. 92, 124 P. 291)

2. Elizabeth Tribble was the holder of a note for the sum of $1,000. While very sick, she gave the instrument to A. J. Tribble causa mortis. She recovered from her illness a few weeks before A. J. Tribble died. In an action brought by Elizabeth Tribble against Annie F. Lisle, it was contended that Elizabeth Tribble was entitled to the return of the note. Do you agree with this contention? (Lisle v. Tribble, 92 Ky. 304, 17 S. W. 742)

3. George McCormick and Adam E. Miller owned land on the opposite sides of the Salt River, the middle of which was the boundary line. Over a period of seventeen years the waters of the stream imperceptibly washed away soil on the side of McCormick and deposited soil on the side of Miller, until there was about fifteen acres of land on Miller's side of the river that had previously belonged to McCormick. An action was brought by McCormick against Miller to gain possession of the fifteen acres. Was McCormick entitled to judgment? (McCormick v. Miller, 239 Mo. 463, 144 S. W. 101)

4. The Aldrich Mining Company mined three thousand tons of coal from a strip of land in Marion County, Alabama. James P. Pearce claimed title to the land and brought an action for conversion of personal property against the company to recover the value of the coal. It was contended that the action was improper in that the action should have been for an injury to real property. Do you agree with this contention? (Aldrich Mining Co. v. Pearce, 169 Ala. 161, 52 S. 911)

5. A. L. Weinberg and another purchased an apple crop from W. A. Claudin. Thereafter an action was brought against them by the Twin Falls Bank & Trust Company on a claim based upon a mortgage given to it by Claudin. In the determination of the case, a question arose as to how the growing crop of apples should be classified as property. What is your opinion? (Twin Falls Bank & Trust Co. v. Weinberg, 44 Ida. 332, 257 P. 31)

6. A partnership, composed of A. H. Johnson, A. L. Mayhew, and W. T. Hudgens, Jr., owned a herd of cattle that had been placed in a pasture northwest of Cisco, Texas. Hudgens bought some cows on his own behalf, branded them with his own mark, and placed them in the pasture with the herd belonging to the firm. Upon the insolvency of

Hudgens, his creditor, the National Bank of Cisco, attached some of the herd belonging to the firm. When the firm brought an action against the bank, it was contended that title to the cattle intermingled by Hudgens with the cattle belonging to the firm passed to the partnership. Do you agree? (National Bank of Cisco v. Johnson, 49 Tex. Civ. A. 242, 108 S. W. 491)

7. The Marbury Lumber Company by mistake constructed a house on the land of M. B. Lamont. Thereafter the lumber company tore down the building. Lamont brought an action against the lumber company to recover damages arising from the demolition of the structure, on the theory of an injury having been done to real property. Was Lamont entitled to judgment? (Lamont v. Marbury Lumber Co., 187 Ala. 436, 65 S. 369)

8. Paul Ertman and Johanna Ertman owned as joint tenants certain real estate located in the state of Wisconsin. Johanna Ertman died, leaving a will by which she bequeathed to John A. Bassler and others each the sum of $200 to be paid out of her interest in the foregoing real estate. After her death, however, Paul Ertman conveyed the property to John Rewodlinksi and others. Bassler and the other legatees contended that the property conveyed by Ertman was subject to the payment of the sums left to them. Do you agree? (Bassler v. Rewodlinksi, 130 Wis. 26, 109 N. W. 1032)

9. Murphy, without permission or license, knowingly entered upon the land of a railroad company, cut the grass thereon, and turned it into hay. The stacks of hay were subsequently destroyed by a fire that started from a spark from an engine of the railroad company. Murphy brought an action against the railroad company to recover the value of the hay upon the theory that the hay belonged to him. Was he entitled to judgment? (Murphy v. Sioux City & P. R. Co., 55 Iowa 473, 8 N. W. 320)

10. Chancy Pleas purchased a tract of land from W. D. and N. L. McLeod. The land at the time was surrounded partly by land belonging to the McLeods and partly by land belonging to other persons. Thereafter the McLeods sold their land to Pat Thomas, who forbade Mrs. Pleas and her children to cross the land to reach a public road. Mrs. Pleas brought an action to compel Thomas to allow her to cross his land for the purpose of reaching the road. Was she entitled to judgment? (Pleas v. Thomas, 75 Miss. 495, 22 S. 820)

11. Cyrus Powers received a deed to property covering a strip of land not owned by his grantor. He built a barn on this strip and claimed the strip for over twenty years. In an action brought by Walter G. Powers against Chris Malavazos to settle title to the strip, it was contended that Cyrus Powers had not gained title by adverse possession because he was not in possession thereof. Was this contention sound? (Powers v. Malavazos, 25 Ohio A. 450, 158 N. E. 654)

12. The city of Vicksburg, Mississippi, granted to Samuel R. Bullock & Company, their associates, successors, and assigns, the exclusive right and privilege to use streets, alleys, public squares, and all other public places within the limits of the city for the purpose of operating a waterworks. Wirt Adams, revenue agent, instigated proceedings against the company and others to collect taxes on the right. It was contended that the right of the company constituted property. Do you agree? (Adams v. Samuel R. Bullock & Co., 94 Miss. 27, 47 S. 527)

13. Alice Ann Walker executed a will in the state of Illinois. Thereafter she acknowledged her signature to Robert Whitlaw, who told his wife, Lucy M. Whitelaw, and David H. Frost of the acknowledgment to him. Thereupon these three persons signed the will as witnesses. A statute required that in case a will is not signed in the presence of the witnesses, the testator must acknowledge his signature to two witnesses at least. In proceedings brought by Fred Walker and opposed by John Walker and others, it was contended that the instrument was not a valid will. Do you agree? (Walker v. Walker, 342 Ill. 376, 174 N. E. 541)

14. The Northern Pacific Railway Company attempted for years to obtain water in the vicinity of Sterling, North Dakota, by sinking wells. During such time it was compelled to haul water to the place in tank cars from Bismarck, a distance of twenty-five miles. Finally it brought an action to condemn land owned by William Kreszeszewski and others for the purpose of constructing a reservoir for the collection of surface waters for use in operating its engines. Was the company entitled to judgment? (Northern Pac. Ry. Co. v. Kreszeszewski, 17 N. D. 203, 115 N. W. 679)

15. A zoning ordinance of the city of Dallas, Texas, prohibited the use of property in a residential district for gasoline filling stations. V. A. Lombardo brought an action against the city to test the validity of the ordinance. He contended that the ordinance violated the rights of the owners of property in such districts. Do you agree with this contention? (Lombardo v. City of Dallas, 124 Tex. 1, 73 S. [2d] 475)

16. C. P. Murray was indebted to Mrs. E. F. McFadden. At the same time his employers owed to him as wages the sum of $130. In an action brought by Mrs. McFadden to subject the sum due Murray to the satisfaction of her claim, Murray contended that the wages due him came under a statutory provision which exempted his real and personal property up to $500 from his creditors. Was his contention sound? (McFadden v. Murray, 32 N. M. 361, 257 P. 999)

17. The Basic City Mining, Manufacturing & Land Company set apart certain strips of its land as streets for the use of the public. The streets, alleys, and highways, as shown on a map prepared and recorded by the company, were expressly accepted by the council of the town of Basic City. The company thereafter sold a lot on one of the streets to

Winston Bell. An action was brought by Bell against the city, contending that the city had no right to use the strip in front of his lot that had been set apart as a street by the company. Do you agree with his contention? (Town of Basic City v. Bell, 114 Va. 157, 76 S. E. 336)

18. Isaac V. Brokaw bought for $199,000 a plot of ground in the borough of Manhattan, city of New York, opposite Central Park, and erected a residence at a cost of $300,000. Thereafter George Tuttle Brokaw acquired an estate for his life in the foregoing property. He decided that he would like to tear down the residence for the purpose of constructing an apartment house on the land. Was he entitled to do this? (Brokaw v. Fairchild, 135 Misc. Rep. 70, 237 N. Y. S. 6)

19. The Muskegon Log Lifting & Operating Company was engaged, under a contract with the original owners, in raising sunken logs known as "deadheads" from the bed of the Muskegon River. In this way the owners of the logs attempted annually to raise logs that had sunk while being floated to the mills. Edgar O. Whitman, who owned a tract of land on the river, brought an action to restrain the company from raising the logs opposite his land, on the ground that he was the owner of the logs. He contended that the logs had been abandoned. Was this contention sound? (Whitman v. Muskegon Log Lifting & Operating Co., 152 Mich. 645, 116 N. W. 614)

20. Louis De Jonge & Company was the owner of a small painting in water colors, called "Holly, Mistletoe, and Spruce." The work consisted of a representation of small branches or sprigs of the flowers of holly, mistletoe, and spruce, arranged in the form of an open cluster, having substantially the outline of a square. In an action brought by the owner against Breuker & Kessler Company, it was contended that the painting was a proper subject of a copyright. Do you agree with this contention? (Louis De Jonge v. Breuker & Kessler Co., 182 F. 150)

21. Mrs. Mary B. Ames had on deposit the sum of $2,563.70 in the Cambridge Savings Bank. Intending to make a gift of this amount to Mrs. Margaret H. Busteed, Mrs. Ames delivered to Mrs. Busteed the bank savings deposit book. It was contended that the gift was invalid for want of delivery. Was this contention sound? (Busteed v. Cambridge Sav. Bank, 306 Mass. 9, 26 N. E. [2d] 983)

22. One Gray committed suicide. Before so doing, while contemplating the act, he delivered his bank savings deposit book to his sister, intending to make a gift of the amount on deposit. Thereafter, it was contended that the transaction constituted a gift *causa mortis*. Do you agree with this contention? (Pikeville Nat. Bank & Trust Co. v. Shirley, 281 Ky. 850, 135 S. W. [2d] 426)

CHAPTER XIII

DEEDS OF CONVEYANCE

Part I—General Considerations

Introduction. The transfer of land is a frequent occurrence in the course of business affairs. Some enterprises are organized for the purpose of engaging almost exclusively in transactions of this nature. In other business ventures, transactions in realty are incidental to the main objects.

It is only within recent times that the nature of ownership in real property has changed with any degree of rapidity. Land law under the feudal system did not provide for frequent changes in titles. Indeed, the very existence of the feudal system was based upon permanence in ownership. The decay of this system was hastened by the development of trade and commerce which demanded full alienability of all types of property.

The early methods of acquiring and disposing of land have been discussed.[1] In feudal times a deed was ordinarily employed only for the purpose of transferring the interest of one who did not have a freehold estate in possession. Today a deed of conveyance is the usual method of transferring ownership in realty. There is, however, a survival of ancient land law in modern deeds, although the technical requirements of the early law have been largely modified or discarded.

The rules of law governing the transfer of land are still very technical and precise. It follows that, generally speaking, a businessman should entrust the details of a transaction in land to someone skilled in real-estate law. He should, however, have some awareness of the problems involved in these transactions. These problems for the most part center around the content of a deed, the execution of a deed, and the effect of the deed as to the rights of the parties and of third persons.

Definitions. The transfer of an interest in land by means of a properly executed written instrument is known as a *deed.*

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[1] *Ante,* Chapter XII, Part III.

The term is also used to indicate the instrument by which the transfer is made. The employment of the term in either sense, however, represents a departure from its original legal meaning. "At common law a deed is 'a writing sealed and delivered by the parties,' but in ordinary language the term is used in a more limited and restricted sense as a conveyance of a fee of land." [2] The party who transfers the land is known as the *grantor*; the person to whom it is transferred is known as the *grantee.*

It is clear from what has been said that there must be two parties to a deed. A grant to a nonexisting person is without legal effect because there can be no transfer unless there is a transferee.[3] The subject matter of a deed must be an interest in land. With some exceptions, any real interest, legal or equitable, may be conveyed by deed. Obviously enough, a person cannot convey land which he does not own, unless he has authority from its owner to convey it. To illustrate, a deed executed by a stockholder purporting to convey land owned by a corporation in which he is merely a shareholder is without legal effect.[4]

A deed should be distinguished from a contract to convey. The former is an executed transaction passing the specified interest from the grantor to the grantee. The latter is an executory transaction, merely an agreement to convey. Whether an instrument is one or the other is an important question which is frequently difficult to answer because of ambiguous or conflicting terms. An instrument, in spite of the fact that in part it purports to be a deed, may be treated as a contract to convey. Thus one court says that "although there are words of conveyance in praesenti in contract for the purchase and sale of lands, still, if from the whole instrument it is manifest that further conveyances were contemplated by the parties, it will be considered an agreement to convey and not a conveyance. The whole question is one of intention to be gathered from the instrument itself." [5]

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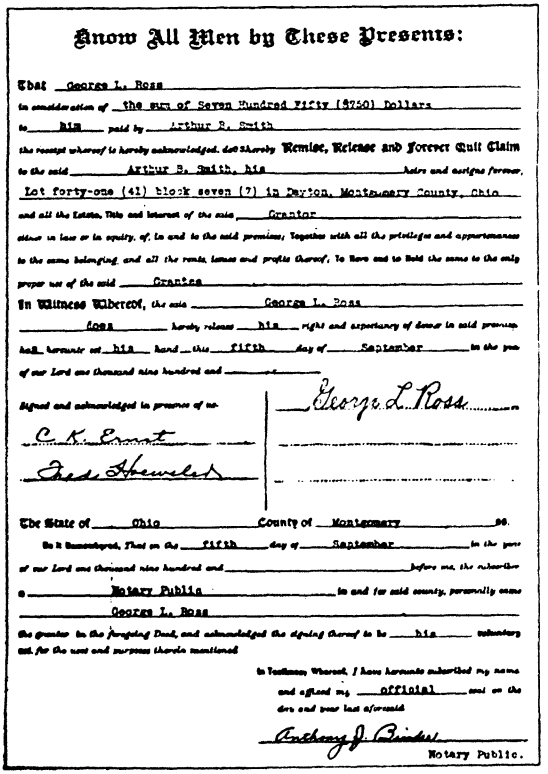
[2] *Saunders* v. *Riedinger*, 30 App. Div. 277, 51 N. Y. S. 937.
[3] *Portage City Bank* v. *Plank*, 141 Wis. 653, 124 N. W. 1000.
[4] *People* v. *Scott*, 22 Calif. A. 54, 133 P. 496.
[5] *Williams* v. *Paine*, 169 U. S. 55, 42 L. Ed. 658.

Classification. A deed of conveyance may take one of two forms, a deed poll or a deed indenture. The latter is also known as an indenture.

Deed Poll. This form of deed is a single instrument, executed by the grantor only. Its name is explained by the fact that the paper or parchment of the instrument was cut even or polled. This form of deed is generally used for conveyances, except when the grantor wishes to bind the grantee to certain express covenants.

Deed Indenture. This form of deed is one executed by both the grantor and the grantee. It is written, or purports to be written, in parts. In former times the parchment or paper was cut unevenly or indented, to provide a method of authenticating the instrument by matching the parts. This practice, from which the name of the deed is derived, has been discontinued.

A deed poll or an indenture may take the form of a quitclaim deed or a warranty deed.



Know All Men by These Presents:

That George L. Ross

in consideration of the sum of Seven Hundred Fifty ($750) Dollars

to him paid by Arthur B. Smith

the receipt whereof is hereby acknowledged, do hereby Remise, Release and Forever Quit Claim

to the said Arthur B. Smith, his heirs and assigns forever,

Lot forty-one (41) block seven (7) in Dayton, Montgomery County, Ohio

and all the Estate, Title and Interest of the said Grantor

either in law or in equity, of, in and to the said premises, Together with all the privileges and appurtenances

to the same belonging, and all the rents, issues and profits thereof, To Have and to Hold the same to the only

proper use of the said Grantee

In Witness Whereof, the said George L. Ross

doth hereunto set his hand this fifth day of September in the year

of our Lord one thousand nine hundred and

Signed and acknowledged in presence of us: George L. Ross

C. K. Ernst

Fred Shemeld

The State of Ohio County of Montgomery ss.

Be it Remembered, That on the fifth day of September in the year

of our Lord one thousand nine hundred and before me, the subscriber

a Notary Public in and for said county, personally came

George L. Ross

the grantor in the foregoing Deed, and acknowledged the signing thereof to be his voluntary

act for the uses and purposes therein mentioned

In Testimony Whereof, I have hereunto subscribed my name

and affixed my official seal on the

day and year last aforesaid

Anthony J. Binder

Notary Public.

QUITCLAIM DEED

Quitclaim Deed. This type of deed purports to convey merely the interest which the grantor has in the subject matter of the conveyance. If the grantor has no interest in the land, the grantee, of course, takes nothing under a quitclaim deed. If, however, the grantor

has an interest in the subject matter, a quitclaim deed will transfer it as any other form of conveyance would. This form of deed is more commonly used to clear up title to an estate or to effect a partition.

Warranty Deed. This form of deed not only operates as a conveyance of the land, but also includes certain covenants or warranties. In other words, such a deed contains stipulations whereby one or both parties covenant that certain facts are true or that certain things will be done. At present this is the most commonly used method of conveying ownership in land.

Form. Most states enforce statutes, similar to the English Statute of Frauds, which require that a deed of conveyance must be in writing and signed by the party to be charged or by his agent. Although there are certain formal parts to a deed, the grantor need not follow them. If the grantor clearly and fully expresses an intention to convey the designated subject matter to a designated grantee, an informal deed is sufficient. Although, as a matter of safety, a deed should be drawn and executed in ink, the use of a pencil does not affect the validity of the deed. Since an instrument written in pencil lends itself to possible undetected alteration, it is in all cases subjected to the close scrutiny of doubt. In some states, statutes provide an acceptable form of a deed. This form should be utilized whenever it is convenient for the person to do so. It is generally held, however, that a statutory form does not prohibit the use of other forms.

Registration of Titles. To remove uncertainties as to titles and to eliminate the cost of examining titles upon each transfer, some states have adopted a system of registration of land titles. The scheme involves the issuance of a *certificate of title* to the owner by a designated officer after proof of ownership. When the title has once been registered, successive or subsequent transferees receive a certificate of title from this officer. This certificate of title is conclusive as to the title of the owner and as to the rights of others in the premises. The plan of registering titles is popularly known as the *Torrens System*, because it was first brought into use in the English-

Know all men by these presents:

That Joseph Bentley and Marie Bentley, his wife
in consideration of One thousand ($1,000) Dollars
to them *paid by* Walter Rathburn
the receipt whereof is hereby acknowledged, do ____ *hereby* **Grant, Bargain, Sell and Convey** *to the said* Walter Rathburn, his ____ *heirs and assigns forever:*
Lot sixteen (16) block three (3) in the Avonlea subdivision
and all the **Estate, Title and Interest** *of the said* Grantors
either in Law or Equity, of, in and to the said premises; **Together** *with all the privileges and appurtenances to the same belonging, and all the rents, issues and profits thereof;* **To have and to hold** *the same to the only proper use of the said* Grantee
his *heirs and assigns forever.*

And the said Joseph Bentley and Marie Bentley
for themselves *and* their *heirs, executors and administrators, do* ___ *hereby* **Covenant** *with the said* Walter Rathburn, his ____ *heirs and assigns, that* they are *the true and lawful owners of the said premises, and have full power to convey the same; and that the title so conveyed is* **Clear, Free and Unincumbered; And further, That** they do ____ **Warrant and Will Defend** *the same against all claim or claims, of all persons whomsoever;*

In Witness Whereof, *The said* Joseph Bentley and Marie Bentley
who hereby release all their *right and expectancy of* **Dower** *in the said premises, have hereunto set* their *hands and seals* ____ *this* fourteenth *day of* October *in the year of our Lord one thousand nine hundred* ____.

Signed and acknowledged in presence of—

P M Davis

E R Hall

Joseph Bentley (Seal)

Marie Bentley (Seal)

State of Virginia, **County of** Norfolk, **ss.**

Be it Remembered, *That on this* fourteenth *day of* October *in the year of our Lord one thousand nine hundred and* ____ *before me, the subscriber, a* Notary Public *in and for said county, personally came* Joseph Bentley and Marie Bentley
the grantors in the foregoing Deed, and acknowledged the signing thereof to be their *voluntary act and deed.*

In Testimony Whereof, *I have hereunto subscribed my name and affixed my* official *seal on the day and year last aforesaid.*

E. R. Stern
Notary Public

WARRANTY DEED

speaking nations through the efforts of Sir Robert Torrens, of South Australia. Since the provisions of the statutes vary considerably in the country, only the general features of the statute of Minnesota will be considered here.[6]

The statute designates the parties who may make application for registration of title. The application must be in writing, signed, and verified. It must substantially set forth the following: (1) the names of the owners, (2) their ages, (3) their residences, (4) whether they are married, (5) a description and assessed value of the land, (6) the estate of the applicant, (7) parties known to have an interest in the land, (8) whether the land is occupied, and (9) liens and incumbrances.

The application is made to the county court and is filed by the clerk in a land register docket. The applicant, as soon as possible, files an abstract of title which is referred to an examiner. If his report is adverse to the applicant, a summons is sent by the court to all parties of interest, making them defendants in what is really an action to quiet title. In the case of a default or a finding for the applicant, the court enters a decree confirming his title and orders its registration.

The decree of registration is filed by the clerk with the registrar of title. The latter issues a certificate of title setting forth the facts required by the statute, which is then entered in a book called the register of titles. The applicant receives an owner's duplicate certificate. In case of a subsequent transfer, this duplicate and a deed of conveyance is given to the registrar who cancels both the original and duplicate certificates and issues a new original certificate which indicates the new ownership. In the case of death the decree of the probate court is given with the duplicate to the registrar, and an owner's duplicate is made out to the heir or devisee. An assurance fund is maintained by the state to reimburse any parties who without fault on their part suffer damages due to erroneous registration.

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[6] *Gen. Statutes of Minnesota*, 1923, ch. 65, §§8247-8329.

QUESTIONS

1. "The methods of transferring ownership in land in feudal times have been found adequate to meet the demands of modern economic activities." Do you agree with this statement?

2. Frankhurst owns a quarter of a section of land. He executes a conveyance of this land, naming Wright as grantee in the deed. Wright has been deceased for a period of several years before the execution of this conveyance. The heirs of Wright sue Frankhurst for possession of the land. Are they entitled to judgment?

3. Stirt and Prelman enter into an agreement in writing under seal. The former agrees to drain a swamp on the latter's farm. Is this transaction known as a deed?

4. Purvis agrees to purchase and Ritchie agrees to sell the latter's half-interest in a given ranch in Wyoming. When questioned about the transaction, Ritchie states that he and Purvis have executed a deed. Purvis denies this assertion. Do you agree with Ritchie or Purvis?

5. Tillotson decides to divide his land among his children. He conveys a farm of one hundred and sixty acres to each of two sons and two city lots to his daughter. All of the conveyances are made by means of deeds executed by Tillotson alone. During a discussion concerning these transfers the sons contend that the form of the deeds is known as an indenture. Is their contention sound?

6. Reese and Murphy are discussing conveyancing. The former contends that title to land cannot be transferred by means of a quitclaim deed. Murphy denies this and states that a person may accept a quitclaim deed to land as safely as a warranty deed. Do you agree with either Reese or Murphy?

7. Boyne brings an action against Duff for possession of a fruit farm in Georgia. At the trial Boyne proves that Burns made an oral conveyance of the farm to him. Is Boyne entitled to judgment?

8. "This indenture witnesseth, that I, Willard O. Armstrong, warrant and defend under Ella Armstrong Cathers, and her heirs and assigns, the receipt of which is hereby acknowledged, the following estate:" (description of the land). This instrument was signed, sealed, and acknowledged as a deed, and was caused to be recorded as such by the person who executed it. Later Willard O. Armstrong made a testamentary disposition of all his property. Cathers, the surviving husband of Ella Armstrong Cathers, brought an action to recover the real estate described in the foregoing instrument. Was he entitled to judgment?

9. Marks agrees to convey a given lot to Boynton for the sum of $8,000 upon the fifteenth day of the following month. Upon that date Marks uses a pencil in drawing and executing a deed of conveyance. Boynton refuses to accept the deed because it is not written in ink. Marks brings an action for damages against Boynton, who contends that Marks has not tendered a valid deed. Is Marks entitled to judgment?

10. "Some states have adopted a system of registration of land titles known as the Torrens System." What is meant by this statement?

Part II—Contents of a Deed

Premises. The first part of a deed is known as the *premises.* The premises consist of descriptions and recitals which form an introductory explanation of the deed and its operation, as well as the purpose of its execution.

Parties. The names of the grantor and of the grantee are generally stated in the premises, although they may appear elsewhere in the deed. Although it is imperative that the deed describe the parties in such a manner that they can be identified with reasonable certainty, it need not designate them by name. To illustrate, if the grantor or the grantee is designated as the devisee of a designated person, the deed is valid.[1] The fact that a grantor uses an assumed name does not of itself render the deed invalid.

Consideration. The premises usually contain a statement of the consideration and its receipt. In some states a recital of the price is necessary; in others it is not. In a large number of states there need not be any consideration actually paid. Both questions are sometimes governed by statute.[2]

Words of Grant. "Words of grant, in some form, are absolutely essential to the passing of an estate by deed." [3] Although it is customary to use certain terms, no particular terminology is required. Any words which indicate an intention to convey the land are generally held sufficient to pass the title.

Description of Property. The property to be conveyed must be so described that it can be identified with reasonable certainty. "It is well settled that a deed wherein the description of the property which it purports to convey is so vague and indefinite as to afford no means of identifying any particular tract of land is inoperative either as a conveyance of title or as color of title." [4] The description may be made by the num-

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[1] *Webb* v. *Den,* 17 How. (U. S.) 576, 15 L. Ed. 35.
[2] *Bergardy* v. *Colonial, etc., Mortg. Co.,* 17 S. Dak. 637, 98 N. W. 166.
[3] *Freudenberger Oil Co.* v. *Simmons,* 75 W. Va. 337, 83 S. E. 995.
[4] *Youmans* v. *Moore,* 144 Ga. 375, 87 S. E. 273.

ber or name of the tract, or by a map, giving section, range, and township. The identification may be made by metes and bounds, courses and directions, or quantities. In case of conflict, natural monuments prevail over artificial monuments; both prevail over courses and distances; and the latter prevail over quantities.

Habendum. The second part of a deed is the habendum clause. The purpose of the habendum is to define the estate granted. It may enlarge or diminish the estate granted in the premises, but it is inoperative when inconsistent with the granting clause. "As illustrations of this rule, when a grant was to one and his heirs, and the habendum was to the heirs of his body, the habendum was given force because it did but explain what heirs were intended in the granting clause; but when a grant was to one and his heirs and the habendum or later clause was to the grantee for his life, or the life of another, the habendum or later clause was considered void as being repugnant to the meaning conveyed by the words 'his heirs' as previously used." [5] The tendency of modern decisions, however, is to abandon the rule that the granting clause overrides the habendum clause. "This doctrine, which regarded the granting clause and the habendum and tenendum as separate and independent portions of the same instrument, each with a special function, is becoming obsolete in this country, and a more liberal and enlightened rule of construction obtains, which looks at the whole instrument without reference to formal divisions, in order to ascertain the intention of the parties, and does not permit antiquated technicalities to override the plainly expressed intention of the grantor, and does not regard as very material the part of the deed in which such intention is manifested." [6]

Reddendum. The reddendum clause is one by which the grantor creates some new right for himself in the estate granted. An example occurs when the grantor reserves a right of way over the land conveyed, which did not exist before.[7]

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[5] *Johnson* v. *Barden*, 86 Vt. 19, 83 A. 721.
[6] *Triplett* v. *Williams*, 149 N. C. 394, 63 S. E. 79.
[7] *Bendikson* v. *Great Northern Ry. Co.*, 80 Minn. 332, 83 N. W. 194.

This is called a *reservation.* It differs from an *exception,* in that the latter retains a right previously existing which would have passed except for this clause. This is illustrated by the grantor who retains a specified part of the tract or the use of a way over the land which is then existing.[8] Another difference is that words of inheritance must be used in case of a reservation, but not in case of an exception. If words of inheritance are omitted in the reservation, the right created exists only for the life of the grantor.

> A reservation "takes back something already granted." An exception "indicates that that contained in it was never granted." (Allen v. Trustees of Great Neck Free Church, 240 App. Div. 206, 269 N. Y. S. 341)

The terms *reservation* and *exception* are often used interchangeably, although technically they refer to different things. The rights of the parties, however, do not depend upon the use of a particular term. "While the distinction between a reservation and an exception is important, it often happens that what is called a reservation is treated and given the effect by the courts as an exception. It is the intention of the parties which is to be ascertained." [9]

Conditions. If the intent is to create a conditional estate, another part of the deed will be devoted to conditions. In connection with conveyancing, the term *conditions* means a clause which stipulates that upon the happening or nonhappening of some contingency, an estate commences or terminates.[10]

The right to impose reasonable and legal conditions upon a conveyance is an incident of ownership. The usual words employed to create a condition are "on condition that," but no particular form of words is necessary. In all cases the intent to create such an estate must be clearly shown. "Conditions are not favored in law, as they tend to destroy estates; but conditions may be created if such an intention appears from an examination of the whole deed. There are certain words which are considered appropriate to create a condition, but

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[8] *State* v. *Wilson,* 42 Me. 9.
[9] *Plistil* v. *Kaspar,* 168 Iowa 333, 150 N. W. 584.
[10] *Ante,* Chapter XII, page 735.

when these apt words are used the provision is not always construed as a condition, and without these words conditions have been found to exist when such appears to be the intention of the parties." [11]

Covenants. Terms and conditions are usually followed by covenants of the grantor as to his title. In some states certain covenants are implied. Covenants may be special, as a covenant against disturbance by the grantor, or general, as a covenant against claims of all persons. The following general covenants are in common use.

Covenant of Seizin. This type of covenant is construed by most courts to mean that the grantor contracts that he has the exact estate which he purports to convey. Thus, if he purports to convey an estate in fee simple, this covenant is immediately broken if he has only a fee simple to a part of the land, or a fee tail to the whole.[12] A *covenant of right to convey* is ordinarily treated as a covenant of seizin.

Covenant Against Encumbrances. This type of covenant is a contract that the land is not subject to any right or interest in third persons, which, although consistent with the passing of title, diminishes the value of the subject matter conveyed. Examples of encumbrances are easements, right of dower, or liens of any kind, such as a mortgage or a lien for taxes.[13]

Covenant for Quiet Enjoyment. This type of covenant is a contract that the covenantee shall not be disturbed in the quiet enjoyment of the premises. It is broken only by an entry of the grantor or of a third person under a title paramount to the title of the covenantee. For example, there is no breach of this covenant when the covenantee is disturbed by one without lawful claim.[14] The eviction may be actual or constructive. The former occurs when the covenantee is required to surrender possession to one with a superior title. The latter occurs when he cannot get possession because it is in one having a superior title. A *covenant of guaranty*

[11] *Ball* v. *Miliken*, 31 R. I. 36, 76 A. 789.
[12] *Comstock* v. *Comstock*, 23 Conn. 349.
[13] *Eaton* v. *Cheseborough*, 82 Mich. 214, 46 N. W. 365.
[14] *Hopper* v. *Cheek*, 21 Ark. 585.

gives a covenantee practically the same rights as that for quiet enjoyment.

Covenant for Further Assurances. This type of covenant is a very important contract of the grantor that he will do any act necessary to perfect the title which he purports to convey. This covenant is frequently enforced by specific performance.

Testimonium. A deed ordinarily ends with a statement setting forth that the instrument has been executed and the time of its execution. This is called the testimonium clause. It begins "In witness whereof" and is followed by such a statement as, 'The said John Doe and Richard Roe [the grantors] have hereunto set their hands and seals," etc., or, "The said party of the first part has signed and sealed this indenture," etc. This clause is not essential to a deed.

The date is usually included in the testimonium clause. It may be expressly stated, or it may be referred to by a phrase such as, "the day and date first hereinabove written." A statement of the date is not essential. A deed is valid although it is falsely dated or is executed without a date. "The date of a deed is not the hour or minute when the deed was executed, but a memorandum of the day when the deed was delivered." [15] Although the date of execution is not necessary to a valid deed, it is important that it be indicated. In the absence of contrary proof, a deed is ordinarily presumed to have been delivered on the day of the date set forth in the instrument.

QUESTIONS

1. Brockton owned a lot on a corner and occupied the adjoining lot under a license from an agent of Dunham, who was at the time its owner. Moore took possession of the lot occupied by Brockton and began felling trees upon it. Brockton brought an action of trespass against Moore. At the trial Moore, claiming title under Dunham, presented a deed from Dunham's heirs in which the grantors were named descriptively, but not individually, as follows: "We, the heirs of J. W. Dunham." Brockton contended that the deed was ineffective because the names of the grantors were not inserted at the beginning of the deed. Do you agree?

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[15] *Oatman* v. *Walker*, 33 Me. 67.

2. Stillman brings an action to eject Heath from a farm containing six hundred acres. At the trial, Stillman produces a deed from the former owner, Lampert. The deed reads: "For value received from George and John Fisher, I, Chester Brandt, hereby make over and confirm unto them, their heirs, executors and administrators forever," etc. Heath contends that the deed is ineffective because it contains no words of grant. Is Stillman entitled to judgment?

3. Chastain sues Stribling for possession of a certain tract of land. At the trial, Chastain produces a deed in which the land conveyed is described as follows: "The southeast part of the southeast ¼ of the northeast quarter of section 36, township 4, south end, range 2 east, containing 32 acres." Stribling contends that the description is too indefinite to make the deed effective. Is Chastain entitled to judgment?

4. Randell conveys certain land to Cummings. The granting clause reads: "Witnesseth to the said George Randell for and in consideration of the sum of one hundred dollars hath remised, released and forever quitclaimed unto the said Francis Bowlder. . . . All his right, title, interest and property." The habendum clause reads: "To have and to hold the above [description of property] with all the privileges and appurtenances thereto belonging to the proper use, benefit and behoof of the said Francis Bowlder, his heirs and assigns forever." It is claimed that Bowlder has only a life estate under this deed. Do you agree?

5. Randolph is contemplating a conveyance of a large portion of his farm to Harrington. He wishes, however, to retain a part of the property upon which there is a grove of walnut trees. In executing the deed, will he retain this part by means of an exception or a reservation?

6. Hull and Dilbert possess land as tenants in common. Dilbert sells his undivided interest to Hesseltine. Later Hull executes a warranty deed to Stearns, purporting to convey the title to this property. The deed contains among other warranties a covenant of seizin. Stearns brings an action of covenant to recover from Hull. Is he entitled to judgment?

7. On the seventeenth day of February, Patterson agreed to convey a piece of ground to Bergun who at that time paid part of the purchase price. On the tenth day of July a deed with the usual covenants was executed in fulfillment of the contract. Between February and July, however, a judgment was rendered against Patterson in an action brought by Meikljohn. In this state a judgment creates a lien on all the real property of the judgment debtor. Did Bergun have a right of action against Patterson for breach of covenant?

8. Belmont conveys a house and lot to Parker by means of a warranty deed. The instrument contains among other warranties a covenant of quiet enjoyment. Later Parker learns that Curtis, who is living in a foreign country, possesses a paramount title to the property. Parker thereupon immediately brings an action of covenant to recover damages from Belmont. Is he entitled to judgment?

Part III—Execution of the Deed

Signature. It was not necessary to sign a deed at common law. Most courts, however, hold that a signature is a requirement of a valid deed, although by statute in some states an acknowledgment by the grantor is an acceptable substitute. In the absence of statute to the contrary, the signature may be in any part of the instrument. The signature must, however, be at the end when the statute prescribes that the instrument shall be subscribed by the grantor.

> The grantor's signature in the acknowledgment certificate was held to be sufficient under a statute requiring the signature at the end of a deed. (Gentry's Guardian v. Gentry, 219 Ky. 569, 293 S. W. 1094)

Some statutes require actual writing of the signature, but in the absence of such a statutory provision this is not necessary. Thus a stamped or printed signature is ordinarily sufficient.[1] Likewise a signature by mark is usually valid, not only in case of an illiterate but also in case of a person who is able to write. In some cases the signature may be affixed by another. To illustrate, a deed is valid when the signature of the grantor is written by another in his presence and at his request.[2] It is also valid when his signature is affixed in his absence but upon proper authorization, or even when the signature is affixed without his knowledge but is later adopted by him as his own.

Seal. A seal was necessary at common law for the execution of a deed of conveyance. This view has been adopted generally in this country either by courts or by statute. In a few states, however, it is expressly provided that an affixing of a seal is not a requisite of a valid deed.

A seal is an impression made upon the paper or parchment, or upon some tenacious substance attached to the instrument. At common law an impression is necessary, but in a majority of states a scroll is permitted by the courts or by statute.

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[1] *Hancock* v. *Bowman*, 49 Calif. 565.
[2] *Bird* v. *Decker*, 64 Me. 550.

The requirements of a seal have been discussed in an earlier chapter.[3]

It is not required that all the parties to a deed use separate seals. In other words, two or more parties may adopt the same seal. To illustrate, a deed, although having only one seal, is valid when the parties subscribe to a clause stating, "We, the grantors, have hereunto set our hands and seals." [4]

Witnesses. To prove the transaction, it is customary to have the execution of a deed attested by witnesses. At common law no witnesses were required. In some states witnesses are essential either to the validity of the deed or to the right to have it recorded. Any form of attestation, unless a certain form is prescribed by statute, is sufficient, provided it indicates that the parties were witnesses to the transaction. In the event that a certain form is prescribed, it must be followed. In the absence of statutory provisions, there is sufficient attestation if the execution of the deed is acknowledged to the witness. Thus one court says: "It is not necessary that he [the witness] should actually have seen the party sign, nor have been present at the very moment of signing; for if he is called in immediately afterwards and the party acknowledges the signature to the witness and requests him to attest it, this will be deemed part of the transaction." [5]

> "At common law the validity of a deed did not depend upon its attestation." (Bliss v. Miller, 119 Oreg. 573, 250 P. 218)

When attestation is required, there must be sufficient competent witnesses. The statutes usually require two or more. One who observes the execution of the deed, or who even attests the document, is not necessarily a competent witness. The parties subscribing as witnesses must do so either at the request of the grantor or with his knowledge and assent. If they have a direct beneficial interest, however, even these parties may prove to be incompetent. To illustrate, the grantee, the husband or wife of the grantee, or the husband

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[3] *Ante*, Chapter I, page 53.
[4] *Tasher* v. *Bartlett*, 5 Cush. (Mass.) 359.
[5] *Tate* v. *Lawrence*, 11 Heisk. (Tenn.) 503.

or wife of the grantor has an interest which will disqualify him or her.[6] It is generally held that the witness must be competent at the time of the attestation. In some states, however, it is enough if he was competent at the time of proving it.

Acknowledgment. In most jurisdictions a deed must be acknowledged by the grantor. In a few jurisdictions the instrument is ineffective even as between the parties until it has been acknowledged. As a general rule, however, an unacknowledged deed is valid as between the grantor and grantee. Most states require an acknowledgment only as a condition precedent to the recording of the deed.

> That an unacknowledged deed "was not, and could not have been, recorded, does not affect its validity as between the parties." (Kitchen v. Canovan, 36 N. M. 273, 13 P. [2d] 877)

An *acknowledgment* of a deed or another document is a declaration before an authorized officer by the party executing the same that this instrument is his act or deed. Acknowledgments are required to be made before a specified official, such as a judge or a notary public. An acknowledgment before an unauthorized officer is, of course, ineffective. To illustrate, if an acknowledgment of a conveyance of a homestead by a man and wife is required to be made before a judge, a clerk of the court, a justice of peace, or a notary public, an acknowledgment before a United States commissioner is ineffective.[7] The officer who certifies the acknowledgment upon the instrument, signs it and affixes to it a seal if he has an official seal. The term *acknowledgment* is sometimes used to indicate this certificate.

> "It is undoubtedly well settled that a substantial compliance with an acknowledgment statute is all that is required." (Maitland v. Republic Refining Co., 109 Okla. 55, 234 P. 754)

The contents of the certificate vary. A usual requirement is that the certificate shall contain a statement that the iden-

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[6] *Corbett* v. *Norcross*, 35 N. H. 99.
[7] *Interstate Savings and Loan Ass'n* v. *Strine*, 58 Nebr. 133, 78 N. W. 377.

tity of the party making the acknowledgment is known to the official. In some states it must state that the party, if a married woman, acknowledges the act to be free and voluntary. Other states also require that the certificate further state that out of her husband's presence she acknowledges the execution to be free and voluntary. These requirements are designed to free the woman from compulsion by her husband.

Delivery. A deed is inoperative and no title passes by virtue of it until it has been delivered. The mere signing and sealing of a deed creates no rights in the grantee. Delivery is a matter of intent and not a matter of physical disposition or manipulation. "No particular form or ceremony is necessary to constitute such delivery. It may be by acts without words or words without acts, or both. Anything which clearly manifests the intention of the grantor that the deed shall presently become operative and effectual, that the grantor shall lose all control over it, and that the grantee shall become possessed of the estate, constitutes a sufficient delivery." [8]

> In some states, if the grantor records a deed, "a manual delivery of the deed thereafter is not necessary to make it effectual." (Turner v. Close, 125 Kans. 485, 264 P. 1047)

Various acts may be relied upon to establish the intent to deliver or, in other words, to surrender control of the deed. A delivery may be made by placing the deed, addressed to the grantee, in the mail, by handing it to the grantee, or by giving it to a third person with directions to hand it to the grantee. In the last situation it must be clear that a surrender of control was contemplated. For example, there is no delivery when a deed is deposited with a third person merely for safekeeping.[9] A manual delivery to the grantee is not, however, considered by most courts as conclusive evidence of delivery, for the grantor may have given it to the grantee for a purpose which did not involve surrendering control over it. Possession of the deed by the grantee does not of itself show a delivery. The grantee may have come into its possession by

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[8] *Riegel* v. *Riegel*, 243 Ill. 626, 90 N. E. 1108.
[9] *Culver* v. *Carroll*, 175 Ala. 469, 57 S. 767.

trickery, force, or fraud, without the consent of the grantor. In some cases, however, when the deed is given to the grantee, or when he wrongfully secures possession, the grantor is estopped to deny delivery if some third person changes his position in reliance on the possession of the deed by the grantee. Thus a grantor signs and seals a deed and knowingly places it where the grantee can easily take possession of it. If the latter takes the deed and conveys it to a bona fide purchaser, the grantor cannot claim want of delivery.[10]

When a deed is delivered to a third person for the purpose of delivery to the grantee upon the happening of some contingency, the transaction is called a delivery in *escrow*. No title passes until the fulfillment of the condition, after which the deed operates as of the time of the first delivery. There is, however, a tendency to modify this rule in favor of bona fide purchasers and creditors.

Acceptance. There must be not only a delivery of a deed by the grantor, but also an acceptance by the grantee. In the absence of an acceptance the deed does not pass title. An acceptance of a deed which is beneficial to the grantee is ordinarily presumed, especially when the grantee is under a disability. One court states: "Whatever may be said in general as to the necessity of acceptance by the grantee in order that title may pass to him, it is well settled that such acceptance will be presumed where the conveyance is in the nature of a gift and imposes no burdensome conditions or obligations." [11]

> A grantee could not assent to a deed "while in utter ignorance of the existence of the deed." (Meade v. Robinson, 234 Mich. 322, 208 N. W. 41)

In the absence of statute, no particular mode of acceptance is necessary. Acceptance may be proved by words, formal or informal, or by conduct or acts. Illustrations of acts indicating acceptance are conveying or mortgaging the land, retaining the deed, or claiming rights which are incidents to ownership.[12]

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[10] *Tischer* v. *Beckwith*, 30 Wis. 55.
[11] *In re Bell*, 150 Iowa 725, 130 N. W. 798.
[12] *Ward* v. *Small*, 90 Ky. 198, 13 S. W. 1070.

QUESTIONS

1. Kenilworth brought an action of ejection against Tierney to recover forty-eight acres of land as heir of Rathburn, deceased. At the trial Tierney introduced a conveyance of the land to him from Rathburn. The deed was signed, sealed, and acknowledged as follows:

Robert His X mark Rathburn

Signed, sealed, and acknowledged
in the presence of

Ralph M. Cole Witness
Bruce Hayward Witness

Kenilworth contended that the deed to Tierney was invalid because it was not properly signed. Do you agree?

2. McIntyre sued Dillman for possession of a certain piece of land. At the trial he (McIntyre) produced a quitclaim deed from the former owner. The latter could neither read nor write at the time of executing the instrument, but he caused the instrument to be made, and he authorized another person to sign his name to the deed. The signing by the third person was done in the presence of the grantor who acknowledged it to be his deed and delivered it to McIntyre. Was McIntyre entitled to judgment?

3. Gainor brings an action of trespass against the heirs of Tremaine. At the trial he proves that Tremaine executed an instrument purporting to convey a given house and lot to him. The instrument contains the words "Sealed with my seal," but has no seal on it. Is Gainor entitled to judgment?

4. The outcome of a certain trial depended upon the validity of a deed. A witness testified that he was called to the house of the grantor to be a witness to the execution of the deed; that when he went to the house the instrument was signed; and that the grantor handed him the pen and requested him to witness the signature. Was the deed properly witnessed?

5. A statute required three witnesses to a valid deed. In the conveyance of a farm by Stickney to Kearns, one of the three witnesses was the wife of the grantor. It was contended that the deed was not properly attested. Do you agree?

6. A suit was brought to have a deed set aside on the ground that the grantor was of unsound mind. At the trial the grantee proved that the deed was acknowledged by the grantor before the proper officer and contended that this fact was conclusive as to the mental capacity of the grantor. Was his contention sound?

7. Donaldson executed and acknowledged a deed with the name of the grantee omitted and placed the instrument in his desk. His brother, who had a key to the desk, took the deed and wrote in the name of Perry as grantee without the consent of Donaldson. Perry conveyed the premises to Taggert. Taggert then brought an action of ejectment against Donaldson. Was he entitled to judgment?

8. Mrs. Charles Jordon, for the purpose of putting certain real estate beyond the reach of her husband, signed and acknowledged a deed in which the land was conveyed to her children, all of whom, with the exception of one, were infants. After the deed was signed and acknowledged, the grantor caused it to be recorded, and then took possession of it intending to retain the deed and the land in her possession until her death. In an action for quiet title it was contended that the deed was ineffective. Do you agree?

9. Leeds executes a deed and delivers it to Limmick as agent of the grantee. It is contended by Harmon that this transaction is a delivery in escrow. Do you agree?

10. Tufts executes a deed purporting to grant a house and lot to Sievert. Sievert refuses to accept the deed. A statute makes the owner of property liable for the care of sidewalks. Stewart who is injured because of the poor condition of the walks in front of this house brings an action for damages against Sievert. Is he entitled to judgment?

Part IV—Rights under a Deed

Recording. A deed which is properly executed and delivered ordinarily passes title as between the parties. It may not be effective, however, as against third parties. All states have recording acts which provide that a deed is ineffective as against subsequent purchasers for value without notice, unless it is properly recorded in the county or counties where the property is located. Against all others, except defrauded creditors, an unrecorded deed is effective. To illustrate, it is valid against the heirs or the donees of a grantor, or purchasers having actual notice.[1]

> "At common law deeds of conveyance and other instruments affecting real estate were not required to be recorded." (Epps v. McCallum Realty Co., 139 S. C. 481, 138 S. E. 297)

What constitutes notice varies according to the circumstances. Although actual notice is sometimes required, notice ordinarily consists of information which would cause a reasonably prudent man to investigate possible adverse claims. Possession of the land by a party other than the grantor, whether known or unknown, is notice. Thus, if the grantee fails to record the deed but moves on the land, his title is valid against a subsequent purchaser even though the latter resides in another state.[2] When a deed is recorded, it gives legal notice to the world. A deed on record, however, is not notice when it is not properly executed or recorded. All conditions precedent prescribed by statute must have been met. For example, record of a deed, not acknowledged as required by law, is not notice.[3]

Liens. A transferee who is not a bona fide purchaser for value without notice takes title to land subject to existing equitable liens. An *equitable lien* is not a right in the premises, but a personal right against the grantor which may be enforced by the court of equity. The law, however, does not favor secret liens; hence one who pays value for the land in

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[1] *Lutz* v. *Mathews*, 37 Pa. Super. 354.
[2] *Woodson* v. *Collins*, 56 Tex. 168.
[3] *Fleschner* v. *Sumpter*, 12 Oreg. 161, 6 P. 506.

good faith without actual or constructive notice takes the land free from such liens. An equitable lien arises when the owner makes a written agreement that his land shall be security for some obligation.[4] In many states the unpaid vendor has an equitable lien upon the land for the remainder of the purchase price. An equitable lien arises in favor of a person who mistakenly but in good faith makes improvements on the land of another.[5]

> A mortgage that is ineffective because of some defect in its execution will usually create an equitable lien on the land described. (Haas v. Rendleman, 62 F. [2d] 701)

A transferee also takes the land subject to existing *statutory liens*, unless he is a bona fide purchaser without notice. There are many various types of statutory liens. A few illustrations will be noted here. In most states a judgment is a lien on the lands of the debtor. In such case, however, in order to charge the public with notice, the requirements of the law, such as recording and indexing, must be met. Taxes are usually made a lien by statute. Liens are frequently created by statute in favor of persons who have added value to the property. These liens are known in general as *mechanics' liens*, but they often protect materialmen as well as mechanics. An important question about such liens is in regard to the time when they attach. In some states the lien attaches when the contract is made; whereas in others it attaches when a claim of the lien is properly filed.

Creditors. The passing of title under a deed may be defeated in some instances by the rights of creditors of the grantor. Following an old English statute,[6] statutes or courts in most states declare that a conveyance for the purpose of hindering, delaying, or defrauding creditors is voidable as against such creditors. The rule is applicable in the case of subsequent creditors, as well as those existing at the time of the conveyance. For example, when one, just before entering into debt, makes a conveyance which he knows is likely to

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[4] *Wayt* v. *Carwithers*, 21 W. Va. 516.
[5] *Henry* v. *Griffis*, 89 Iowa 543, 56 N. W. 670.
[6] *Statute 13, Elizabeth*, ch. 5.

render him unable to pay his obligations, the subsequent creditor may avoid the conveyance.[7] When the transfer is made to a bona fide purchaser without notice, the title passes under a deed free from the demands or claims of either existing or subsequent creditors.

Another situation in which the claims of creditors may defeat the passing of title is that in which the conveyance violates a provision of the Federal Bankruptcy Act. Under the provisions of this act, a conveyance which operates to give a preference to one creditor as against another may be set aside if the conveyance was made within four months prior to the time when the grantor was adjudged a bankrupt. The trustee in bankruptcy is also authorized to avoid any conveyance which is a fraud upon creditors.[8]

Abstract of Title. Because a purchaser takes a deed subject to all rights of third parties of which he has notice, it is customary to demand that the grantor furnish an *abstract of title*. This is an instrument containing brief statements as to the material parts of deeds and other transactions of record which affect the particular land.

> "An abstract of title is an epitome of the conveyances, transfers and other facts relied upon as evidence of title, together with all such facts appearing of record as may impair the title." (Freeman v. Abstractors Bd. of Examiners, 99 Mont. 564, 45 P. [2d] 668)

In all states an abstract of title is taken from the public records, but the preparation thereof varies, depending upon sources of information. In many states, when a deed or other document affecting land is filed for record, a concise notation of the material parts is entered in a book kept for this purpose. This information is then transferred to a book or file which contains data under the description of the particular land. It is also transferred to a book or file under the names of the parties. Another book or file is maintained for daily registration of all judgments or of actions brought which involve the property. Information as to special assessments,

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[7] *Snyder* v. *Free*, 114 Mo. 360, 21 S. W. 847.
[8] *Mason's U. S. Code*, 1926, Title II, ch. 7.

tax sales, and the like is usually registered daily in separate books or files.

The party making an abstract searches these books or files, noting all references to the land in question and the parties concerned. The abstract is usually prepared by an attorney at law, by a public official, such as the recorder or the registrar, or by an abstract company. When completed, the document is presented to the prospective purchaser who then has his attorney render an *opinion of title.* If there are any defects in the chain of title or if any encumbrances are discovered, the grantor is informed so that he may clear the title, if such is possible. Clouds on the title may in some instances be removed by quitclaim deeds or by affidavits.

Insured Titles. Although of comparatively recent origin, the practice of insuring titles is quite generally followed throughout the country. The growth of this practice is the result of two factors. First, an abstract of title may not be properly made or interpreted, or, when complete, may not disclose all defects. Second, there is the hazard of the possible inability of the grantor to make good on covenants which are given to protect the grantee against defects in title. The business of insuring titles is now handled almost exclusively by companies organized for that purpose. Most states provide for the creation of corporations to guarantee or insure owners of real property against loss due to defective titles or encumbrances.

> "The object of a purchaser in procuring a guaranty of title, is to secure himself additionally in the performance of the obligations of the grantor." (Shaver v. Title Guaranty & Trust Co., 163 Tenn. 232, 43 S. W. [2d] 212)

The right of the owner on a policy depends largely upon its terms. The policy may create absolute liability or guarantee against any loss. On the other hand, it may insure only against certain risks, such as marketable title, liens, or other defects. For example, the policy may provide that there is no protection against deeds or encumbrances not of record.[9]

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[9] *Bothin* v. *Calif. Title Ins., etc., Co.*, 153 Calif. 718, 96 P. 500.

In the case of a loss to the owner due to a risk not within the terms of the policy, no liability on the part of the company is created.

Policies which guarantee or insure titles are strictly contracts of indemnity; hence only the amount of the loss may be recovered. Thus, in case of the risk of encumbrances only, the liability of the company is for the difference between the value of the land without such encumbrances and the value of the land as it stands with them.[10] If the defect of title is such as to cause a total loss, then the liability of the company is for the value of the land, not exceeding the amount of the policy.

QUESTIONS

1. Jurnel acquired title to a given farm by a warranty deed from Lewy on the sixth day of December. The deed was not recorded. Lewy died on the tenth day of the following May, and his heirs went into possession of the land. Jurnel brought an action of ejectment against the heirs. Was he entitled to judgment?

2. Ivans conveys his farm by deed to Beatty on the fifteenth day of July. On the fourth day of September he conveys the same property to Kaplan who goes into possession. Beatty brings a suit against Kaplan for possession of the property. At the trial Beatty proves that his deed was recorded on the sixteenth day of July. Kaplan proves that the deed on record showed only one witness instead of two as required by law. Is Beatty entitled to judgment?

3. Dooley acquires title to a farm by a warranty deed from York and goes into possession. The deed is not recorded. Later York conveys the same property to Wexler. Wexler brings an action of ejectment against Dooley. Is he entitled to possession of the land?

4. Linley, by mistake, builds a garage on Neil's land. Later Neil conveys the property to Borden. Linley now asserts that he has a lien on the property for the value of this improvement. Do you agree?

5. Haupt, who owed several creditors various sums amounting to ten thousand dollars, owned a vacant lot worth five thousand dollars. He told his friend Artwait that he feared the creditors would take this property. At Artwait's suggestion, Haupt sold him the land for five thousand dollars. Were the creditors entitled to have the deed to Artwait set aside?

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[10] *Glyn* v. *Title Guarantee, etc., Co.*, 132 App. Div. 859, 117 N. Y. S. 424.

6. Kinnear, who owes several creditors, conveys a vacant lot while insolvent to Brown, one of the creditors. The value of the lot just equals the amount of the debt owed to Brown. Two months later Kinnear is judicially declared a bankrupt. The trustee in bankruptcy brings suit to have the deed set aside. Is he entitled to judgment?

7. Dunne conveys a given piece of land to Forester who does not obtain an abstract of title. Forester discovers later that Cullen has a judgment lien on the property. He is told that this encumbrance would have been discovered had he obtained a properly prepared abstract of title. Has he been correctly advised?

8. Seeley, after obtaining an abstract of title which disclosed no encumbrances, purchased a house and lot from Grenner. The latter conveyed the property by means of a warranty deed. Seeley contended that under these circumstances there was no possibility of loss to him. Do you agree?

9. Krane purchases a home and insures his title against loss due to encumbrances not shown on record. It is discovered later that the grantor had previously conveyed the house and lot to Sydham whose deed was on record at the time of the conveyance to Krane. Is the company liable on the policy to Krane?

CASES FOR REVIEW

1. Howard Browning and his wife conveyed a certain tract of land to D. A. Fishel. The deed contained a covenant for quiet enjoyment. Thereafter Fishel was evicted from the land by persons who were mere trespassers, having no title to the land and no right to the possession thereof. Fishel brought an action against the Brownings, contending that there was a breach of warranty. Do you agree? (Fishel v. Browning, 145 N. C. 71, 58 S. E. 759)

2. C. B. Chase was indebted to the Graham Grocery Company and others, but he made no effort to pay the obligations. He conveyed certain tracts of land without consideration to his wife, with the intent to hinder, delay, and defraud his creditors, leaving only a lot worth $100 and his earnings as a laborer for the satisfaction of the claims of his creditors. The grocery company and the other creditors brought a suit to have set aside the conveyances to Mrs. Chase. Were they entitled to judgment? (Graham Grocery Co. v. Chase, 75 W. Va. 775, 84 S. E. 785)

3. John D. Stout prepared certain deeds for the conveyance of certain tracts of land. He signed, sealed, and acknowledged the instruments, which he placed in a sealed envelope indorsed: "Deeds by John D. Stout, to be delivered to John D. Stout on demand, or to J. V. Mitchell, should he be living, thirty days after the death of John D. Stout, to be delivered to the grantees." The envelope was deposited for safekeeping in a bank at Martinsville, Indiana, in the name of John D.

Stout. In an action brought by Nancy A. Stout against James K. Stout and others, it was contended that the foregoing instruments were not valid deeds. Do you agree? (Stout v. Stout, 28 Ind. A. 502, 63 N. E. 250)

4. Annie E. Peterson acquired a lot in the city of Memphis, Tennessee. She and her husband executed an instrument which recited that "this document is to show that we, Annie E. Peterson and Nelson Peterson, have agreed to sell to Nelson Johnson" the foregoing lot. The instrument recited the consideration and then stated: "Now it is understood that should Johnson pay these notes at maturity, we agree to make him, or as he may direct, a deed to said premises." In an action brought by Isabella Peterson against Henry Reichman to recover possession of the lot, it was contended that the foregoing instrument was a deed of conveyance. Do you agree? (Peterson v. Reichman, 93 Tenn. 71, 23 S. W. 53)

5. Mabel Kemp Wheeler conveyed by deed to Alma Werner certain premises located in the borough of Manhattan, New York. The deed contained a covenant for further assurances. During subsequent litigation it was contended that, if the deed did not convey the title intended, the covenantee could compel the grantor to make any further conveyance necessary to vest such title in the grantee. Was this contention sound? (Werner v. Wheeler, 142 App. Div. 358, 127 N. Y. S. 158)

6. Edward J. Borstad agreed to sell certain lots located in Dell Rapids, South Dakota, to Lewis O. Grinne. James W. Cone was employed to prepare the abstract of title. He failed to note on the abstract a judgment against Borstad that created a lien on the land. In an action brought by A. H. Stephenson, as administrator of the estate of Grinne, against Cone, it was contended that the abstract should have shown the existence of such judgment. Do you agree? (Stephenson v. Cone, 24 S. D. 460, 124 N. W. 439)

7. William W. Ripley brought an action against George E. Trask to settle the title to a certain strip of land. Ripley's title was obtained through a person who had received a quitclaim deed from George Jones, who was admitted to be the absolute owner at the time of executing the deed. Ripley contended that the grantee under the quitclaim deed from Jones had become the absolute owner. Was this contention sound? (Ripley v. Trask, 106 Me. 547, 76 A. 951)

8. A. C. Combs and his wife, owners of a tract of land on Darb's Fork of Lot's Creek in Perry County, Kentucky, conveyed the minerals underlying the tract to Fielden Combs. The minerals were conveyed by Fielden Combs to T. P. Trigg, who in turn conveyed them to the Virginia Iron, Coal & Coke Company. After making the conveyance to Fielden Combs, the grantors conveyed the tract of land to Jackson and Alonzo Combs, who had knowledge of the former deed that had not been properly certified and recorded. Jackson Combs brought an action against the coal company to quiet title to the minerals. Was he entitled to

judgment? (Virginia Iron, Coal & Coke Co. v. Combs, 186 Ky. 261, 216 S. W. 846)

9. Wolcott acquired from Goodhue possession of a certain lot of land that was part of a tract known as the Sioux Half-Breed Scrip. Wolcott conveyed the lot to Bowne by a deed containing a covenant of seizin. At the time of the conveyance, Wolcott was the owner of the full equitable and beneficial interest in the lot, but the legal title was held by the United States. Bowne brought an action against Wolcott, contending that there was a breach of warranty. Do you agree? (Bowne v. Wolcott, 1 N. D. 415, 48 N. W. 336)

10. The Center Creek Mining Company leased certain land to the Good Shepherd Mining Company for mining purposes. T. F. Coyne and others, partners, had an apparent mechanics' lien on the foregoing land. In an action brought by the Center Creek Mining Company against the members of the partnership, it was contended that the apparent lien cast a cloud on the company's title. Do you agree? (Center Creek Mining Co. v. Coyne, 164 Mo. A. 492, 147 S. W. 148)

11. Hugh Ford executed a deed conveying his interest in certain property to his brother, Michael C. Ford. The deed described the property as all ranches, lands, houses, barns, stables, and corrals belonging to said Ford Brothers Cattle Company, located on the Belle Fourche River, Butte County, South Dakota. In an action brought by Celestia C. Ford and her daughter against Anna J. Ford, it was contended that the foregoing deed was invalid because of the description of the property. Do you agree? (Ford v. Ford, 24 S. D. 644, 124 N. W. 1108)

12. The New England Mortgage Security Company conveyed a tract of land to A. E. Brodie. The deed contained a covenant against encumbrances. At the time of the conveyance, part of the land was held under a lease by J. A. McGhee for turpentine purposes. Brodie brought an action against the company, contending that there was a breach of warranty. Was this contention sound? (Brodie v. New England Mortgage Security Co., 166 Ala. 170, 51 S. 861)

13. Pedro Guirre and his wife conveyed a tract of land to Zeno B. Clardy and another by deed that granted all of the tract "except three acres upon which our residence now is." In an action brought by L. A. De Roach and others against Allie D. Clardy and others, a question arose as to whether that part of the deed saving the three acres was a reservation or an exception. What is your opinion? (De Roach v. Clardy, 52 Tex. Civ. A. 233, 113 S. W. 22)

14. M. J. O'Brien, owner of certain land in Chattanooga, Tennessee, executed a deed of conveyance under a statute that required two witnesses. The deed was attested by Mrs. Natalie O'Brien, wife of the grantor, and another, as witnesses. In an action brought against O'Brien by a creditor, it was contended that the foregoing deed was not properly witnessed. Do you agree with this contention? (Chattanooga Third Nat. Bank v. O'Brien, 94 Tenn. 38, 28 S. W. 293)

CHAPTER XIV

MORTGAGOR AND MORTGAGEE

Part I—General Considerations

Introduction. A mortgage is a credit device of great importance in the field of business. Similar to a pledge, it is a device by which the debtor may obtain credit by giving the creditor assurance that the debt will be paid. The pledge is useful in many situations. There are two situations, however, in which a business must resort to other devices. In the first place, when a business wishes to borrow large sums of money, it may be impossible, or at least undesirable, to pledge sufficient personal property as security. In the second place, when a business is engaged in selling its goods on installments, the debtor may have little, if anything, to pledge. In these situations the mortgage plays its principal role.

The modern mortgage had its origin at an early time in England in two forms of credit devices known as a *vadium vivum* and a *vadium mortuum*. The first, frequently called a living pledge, was a pledge of property under which the profits and rents derived from the property were applied to the debt. Under the second type of pledge the rents and profits belonged to the creditor. The vadium vivum did not come into general use. The common-law mortgage accordingly really had its origin in the vadium mortuum, or dead pledge. The term *mortgage* resulted from a substitution of the French words *mort* (dead) and *gage* (pledge) for the equivalent Latin terms. The National Commission on Uniform State Laws proposed in 1926 a Uniform Chattel Mortgage Act and in 1927 a Uniform Real Estate Mortgage Act.[1] Provisions of these acts will be cited or quoted for comparison, although in 1943 the commission decided to reconsider them.

Mortgages are becoming more important in the field of business. Although the use of mortgages in the financing of

[1] The act relating to personal property is hereinafter called the Chattel Mortgage Act. The act relating to real property is hereinafter called the Uniform Mortgage Act.

business has not increased as rapidly as the use of other credit devices, there is a growing tendency to use the mortgage as a marketing device. A businessman should therefore have an appreciation of the principles governing problems arising out of the mortgage relation. These problems particularly involve the rights and duties of the creditor and debtor before and after the maturity of the obligation for which a mortgage has been given as security.

Definition. An agreement whereby an interest is created in property as security for an obligation and which is to cease upon the performance of the obligation, is known as a *mortgage.* When the transaction relates to personal property, the agreement is known as a *chattel mortgage.* When it relates to real property, the agreement is known as a *real mortgage.* The person whose interest in the property is given as security is called the *mortgagor.* The person who receives security is known as the *mortgagee.*

> "A mortgage is not a debt, but merely security for the payment of the debt." (Maine v. Clark, 43 Ariz. 492, 33 P. [2d] 283)

A mortgage is based upon the assent of the parties and arises only in connection with some debt or obligation to be secured. It is sometimes difficult to determine whether a given transaction is a mortgage or some other relation. There are, however, three outstanding characteristics of a mortgage: first, the termination of the interest created upon the performance of the obligation; second, foreclosure upon failure to perform; and, third, the mortgagor's right to redeem.

Courts do not hesitate to take other circumstances into consideration in determining the character of the transaction; but if it appears from all circumstances that the parties intended to create a mortgage, they will treat the agreement as such, regardless of what the transaction purports to be. Thus, even when there is an apparent absolute conveyance or sale of property, the transaction will be given the effect of a mortgage if the parties intended the conveyance to be for security only.[2]

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[2] *Hannay* v. *Thompson,* 14 Tex. 142; *Uniform Mortgage Act,* §1.

The Chattel Mortgage Act provides that "(a) an instrument purporting on its face to effect an absolute transfer of goods or book accounts, or (b) a sale of goods or book accounts in conjunction with which the seller retains or receives an option to repurchase all or part thereof, or (c) an apparent sale of goods accompanied by delivery thereof, may be proved to have been intended as a mortgage, and when so proved shall be given effect as such." [3]

Classification. Mortgages are of two kinds, namely, common-law and equitable mortgages.

Common-Law Mortgages. This form of mortgage is a conveyance or sale of property, unconditional in form, subject to be defeated upon the fulfillment of the obligation secured. At common law the legal title, subject to defeasance, passes to the mortgagee who acquires absolute title upon the mortgagor's failure to perform strictly the obligation. This is known as the *legal* theory of mortgages. The English court of equity, however, seeing that the legal theory in many instances brought about a forfeiture of the mortgagor's property to the extent that it was worth more than the amount of the debt, treated a mortgage as no more than a lien on the property for security of the debt. This is known as the *lien* theory of mortgages.

> "A mortgage is simply a lien fixed upon property as security for the payment of a debt or the performance of an act." (Jones v. Hall, 90 Mont. 69, 300 P. 232)

Some states follow the legal or common-law theory of mortgages entirely or with modification, whereas others follow the theory of equity that a mortgage is only a lien. The Uniform Mortgage Act adopts the latter theory.[4] The Chattel Mortgage Act adopts neither theory, but it is drawn so that its provisions are applicable in states following either theory.

Equitable Mortgages. In a given case the parties may intend that a certain property shall be pledged as a security, but they may omit some formal requisite so that the agreement

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[3] §4.
[4] §2—(1).

Know all men by these presents:

That David Starr of Manhattan, Riley County, Kansas in consideration of the sum of One Thousand ($1,000) Dollars to him paid by John A. Pendery the receipt whereof is hereby acknowledged, do as hereby **Grant, Bargain, Sell and Convey** to the said John A. Pendery, his heirs and assigns forever. Lot forty-six (46) Block four (4) in the Roselawn subdivision and all the **Estate, Title and Interest** of the said grantor either in Law or Equity, of, in and to the said premises; **Together** with all the privileges and appurtenances to the same belonging, and all the rents, issues and profits thereof; **To have and to hold** the same to the only proper use of the said grantee his heirs and assigns forever.

And the said David Starr for himself and his heirs, executors and administrators, does hereby **Covenant** with the said John A. Pendery, his heirs and assigns, that he is the true and lawful owner of the said premises, and has full power to convey the same; and that the title so conveyed is **Clear, Free and Unincumbered; And further,** That he does **Warrant and Will Defend** the same against all claim or claims, of all persons whomsoever; **Provided, Nevertheless,** That if the said David Starr shall well and truly pay or cause to be paid, his certain promissory note of even date herewith, for One Thousand ($1,000) Dollars drawn to the order of John A. Pendery and payable in three years from date, with interest at eight (8) per cent per annum then this mortgage shall be void.

In Witness Wherrof. The said David Starr who hereby releases all his right and expectancy of **Dower** in the said premises, has hereunto set his hand this twenty-fourth day of June in the year of our Lord one thousand nine hundred ,

Signed and acknowledged in presence of—

K A Davidson

Doris Anstead

David Starr

State of Kansas, **County of** Riley, **ss.**

Be it Remembered, That on this twenty-fourth day of June in the year of our Lord one thousand nine hundred and , before me, the subscriber, a Notary Public in and for said county, personally came David Starr the grantor in the foregoing Mortgage, and acknowledged the signing thereof to be his voluntary act and deed.

In Testimony Wherrof, I have hereunto subscribed my name and affixed my official seal on the day and year last aforesaid.

P M Reis
Notary Public.

MORTGAGE

is not enforceable at common law as a mortgage. A court of equity, however, more impressed by intent than by form, will treat the agreement of the parties as creating a lien. To illustrate, when a debtor has paid part of a debt and has agreed to execute a new mortgage for the balance due in consideration of a release of the existing mortgage, a court of equity will enforce the agreement as a lien upon the property.[5] These and similar transactions are known as *equitable* mortgages. The term is aptly used since an equitable lien is in equity ordinarily equivalent to a regular mortgage. Equitable mortgages are governed by the provisions of both the Uniform Mortgage Act and the Chattel Mortgage Act.

Property Subject to Mortgages. In general any form of property which one may sell or convey may be the subject matter of a mortgage. "Everything which may be considered as property, whether in the technical language of the law denominated real or personal property, may be the subject of mortgage, as advowsons, rectories, tithes. Reversions and remainders being capable of grant from man to man, and possibilities also being assignable, are mortgagable, a mortgage of them being only a conditional assignment. Rents, also, and franchises may be made the subject of mortgage." [6]

> When two sisters, Minnie and Johanna, each held an undivided half interest in land, the court held that "the contention that Johanna could not mortgage her undivided half interest is without merit." (Ruble v. Grafton Nat. Bank, 64 N. D. 129, 250 N. W. 784)

It is not necessary that the mortgagor have complete or absolute ownership in the subject matter. He may mortgage any interest, legal or equitable, divided or undivided, which he owns. At common law it was imperative that he have an interest at the time of giving the mortgage. This rule was based upon two principles: first, that a mortgage is a conveyance; and, second, that at law a person cannot convey that which he does not presently own. In equity, however, when a person purports to mortgage property which he does

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[5] *King* v. *Williams*, 66 Ark. 333, 50 S. W. 695.
[6] *Curtis* v. *Root*, 20 Ill. 518.

not own, the mortgage attaches when he acquires the property.

> "It is settled that an 'after-acquired' property clause in a mortgage or deed of trust is valid and enforceable in equity." (Prentiss Mercantile Co. v. Thurman, 173 Miss. 6, 161 S. 746)

As to after-acquired personal property, the Chattel Mortgage Act states that "as to goods or book accounts a mortgage shall be valid between the parties which covers goods under contemplation of immediate acquisition, or which covers (a) goods to be raised or grown, or (b) the increase of animals mortgaged, or the wool-clip thereof, or (c) which covers, in conjunction with a present mortgage of described goods or book accounts, further goods or book accounts of like description to be acquired, or (d) which, being made by a corporation, business trust or other business association to secure a debt of not less than twenty thousand dollars, covers, in addition to the described realty, (i) present and after-acquired goods brought on such realty and used in conjunction therewith for the business purposes of the mortgagor; or (ii) present and after-acquired book accounts of the mortgagor; or (iii) all the property, real or personal, of the mortgagor." [7]

Obligation Secured. A mortgage may be given to secure the performance of some act or the performance of a present or future, contingent or absolute liability. When given for a money claim, the amount may be liquidated or unliquidated. Generally speaking, the obligation secured includes all extensions or renewals of the original obligation. It does not, however, include any obligations not described in the mortgage. For example, if a mortgage recites that it is given as security for the purchase of goods, it cannot be enforced for other claims against the mortgagor held by the mortgagee.[8]

> A mortgage to secure repayment of $1,050, "according to the promissory note of even date herewith," covered only that sum, notwithstanding the note also promised payment of an open account. (Carroll v. Chauret, 241 Mich. 338, 216 N. W. 913)

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[7] §17.

[8] *Murphy* v. *Hellman Com. Trust, etc., Bank*, 43 Calif. A. 579, 185 P. 485.

In some transactions, such as a building loan, a mortgage to secure future advances is convenient and desirable. Courts have maintained a difference of opinion as to the validity of provisions for future advances. The Uniform Mortgage Act declares that "a mortgage, given to secure future advances in whole or in part, has the same priority for such advances as if they were made at the time of the giving of the mortgage. If, however, the making of the future advances is optional with the mortgagee, such advances as are made after the mortgagee has actual knowledge of another encumbrance, shall rank subsequent to such encumbrance." [9] The Chattel Mortgage Act provides that a mortgage may validly provide for future advances made within three years, and in a few cases, within a longer period, from the time when the mortgage was executed; but, generally speaking, future advances must be placed on record to have priority over third persons.[10]

In some cases a mortgage debt may be evidenced by more than one instrument. This presents a question as to priority of the holders of the different parts in respect to the security. Three different rules have been developed as to the rights of these parties. Some states give priority according to the time of the maturity of the notes. Others give priority according to the time of negotiation. The third group treats all of the notes alike. The last rule, or the rule of equality, is adopted by the Uniform Mortgage Act.[11]

Form of Mortgage. A mortgage is almost universally required to be in writing. A mortgage upon real property, since it transfers an interest therein, is required to be in writing by the terms of the Statute of Frauds. As a general rule no particular form of language is required, provided the language used clearly expresses the intent of the parties. In states following the legal theory, however, the mortgage must be in the form of a conveyance since it transfers a legal title. This form of mortgage is usually employed even in states following the lien theory. In many states, statutes provide a form of mortgage which may be used.

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[9] §6.
[10] §§19 and 44.
[11] §8.

> "A mortgage or other lien upon real estate cannot be given by parol." (West v. First Baptist Church of Taft, 123 Tex. 388, 71 S. W. [2d] 1090)

A mortgage is ordinarily drawn and executed with all the formality of a deed. These two instruments are practically identical with the exception that a mortgage contains a defeasance clause, a description of the obligation secured, and sometimes a covenant to pay or to perform the obligation.

> "A mortgage may be in the form of a deed containing a provision for a defeasance." (Louisville Joint Stock Land Bank v. Kenner, 255 Ky. 44, 72 S. W. [2d] 751)

Property is often conveyed to one or more persons as trustees to hold it as security for the benefit of holders of bonds or notes. This is a common practice of corporations when they pledge their property as security for a large debt held by many creditors or bondholders to whom it is impractical to give separate mortgages. Although such mortgages are often referred to as *trust deeds*, they are, strictly speaking, *trust mortgages*, for not all trust deeds are mortgages. "Where a deed of trust is executed with the understanding between the parties that the title is to be transferred forever from the grantor to the grantee and his heirs or grantees, then such deed of trust is not a mortgage. But where the deed of trust is executed with the understanding between the parties that when the debt is paid the title shall be again placed in the grantor, such deed of trust is a mere mortgage." [12]

QUESTIONS

1. "In some situations a mortgage is a more useful credit device than a pledge." What is meant by this statement?

2. Trout brought an action of ejectment against McIlwain to recover a water ditch. At the trial Trout produced an instrument in writing by which a ditch company "granted, bargained, and sold" this particular water ditch to him. By the same instrument Trout was authorized "to collect, demand and receive the rents, issues, and profits, and the entire proceeds" of the ditch, or sufficient to meet the payments of the installments to the sum of twelve thousand dollars. The instru-

[12] *McDonald* v. *Kellogg*, 30 Kans. 170, 2 P. 507.

ment also provided that upon the payment of the installments, the conveyance should be void. McIlwain's defense was that the instrument was only a mortgage and did not entitle Trout to possession. Do you agree?

3. Maitland conveys his house, farm, and other lands to his son, Ralph, in consideration of an agreement executed by the latter in which he agrees to support his father during his life. Ralph also executes a bond to reconvey the property if he should neglect to support his father in accordance with the terms of the bond. Upon Ralph's failure to perform the conditions of the bond, Maitland brings suit for relief in equity. He contends that the deed and bond constitute a mortgage. Is his contention sound?

4. "Some states follow the legal theory of mortgages, but most states follow the equitable theory." What is meant by this statement?

5. Erwin S. Holdsworth brought suit to establish a lien against certain property owned by Medley. At the trial it was proved that Medley delivered to Mr. Holdsworth a deed, by which Medley acquired title to the property, and the following instrument:

> Kansas City, Mo., November 25, 19—. The inclosed papers are deposited with Holdsworth, to secure him against loss by reason of signing my bonds as a county depositor. This includes the Kansas City property, which is pledged to him as above stated. Arthur E. Medley.

Holdsworth contended that the transaction created an equitable mortgage. Do you agree?

6. Pollard executed an agreement to purchase certain land from Birt and paid a portion of the purchase price. Later Pollard borrowed some money from Proctor and gave a mortgage on his interest in the land. Proctor foreclosed the mortgage and then claimed that he was the owner of the land. Do you agree?

7. Rose Murray had entered into an agreement with Lingard by which she had been given the privilege of purchasing certain tracts of land on the payment of a given price, provided the agreement was fully carried out within a period of three years. At the end of this period she purchased a few parts of the land. Their rights were adjusted, and the agreement abandoned by mutual consent. Later Rose Murray mortgaged all of her property to Prothero. Previous to the mortgage, however, the piece of property held by her had been conveyed to other persons. Prothero foreclosed the mortgage and claimed by virtue thereof rights in the land owned by Lingard. Was his claim valid?

8. Hallam died intestate, leaving two children and a widow. The widow borrowed fourteen hundred dollars from Wakeman and executed

a mortgage on her undivided share of the land left by the deceased husband. Later Montague purchased the interests of the children and the widow in the land. He then claimed title free from Wakeman's mortgage. Was Montague's claim valid?

9. Figgis executes a mortgage on his apartment house to secure three notes payable to Stephens. These notes, which mature at different times, are negotiated respectively to Taylor, Adams, and Ranke. Ranke, whose note matures first, contends that he is entitled to have the first benefit of the mortgage. Do you agree?

10. The Ayres Commission Company issued a promissory note for four thousand dollars to Robertson and executed a mortgage on a given piece of land including an elevator, cribs, and other fixtures. Later Lodge secured judgment against the company. He claimed that his judgment lien was prior to Robertson's rights, on the ground that the Ayres Commission Company and Robertson had by mistake used a form of chattel mortgage and the instrument was therefore not a mortgage on the real property. The words of conveyance in the form used were "grant, sell, convey, and confirm." Robertson contended that the agreement was sufficient to create a mortgage on the real property described. Do you agree?

11. The American Hotel Company issues bonds valued at seventy thousand dollars. To secure these bonds, the hotel company conveys its property to a title and trust company as trustee to hold it as security for the benefit of the bondholders. It is contended that the conveyance to the title and trust company is a trust deed. Do you agree?

Part II—Rights and Duties of Mortgagor

Possession and Use of Property. The parties to a mortgage at common law may agree as to possession and use of the property. In the absence of agreement, under the legal theory the mortgagee is entitled to immediate possession of the property. In many states, courts hold that the mortgagee may take possession after default. Courts in other states deny him this right. The latter view is adopted by the Uniform Mortgage Act "even though the mortgage contains a conveyance, or agreement for possession by the mortgagee, or pledge of the rents and profits, or other provision to the contrary." [1] If, however, the mortgagee is lawfully in possession, he is entitled to remain until the obligation has been performed. In some states it is sufficient if the possession is acquired peacefully or lawfully, whereas in others the mortgagor's consent to the mortgagee's possession is necessary. The Uniform Mortgage Act declares that when "the mortgagee with the consent of the mortgagor, or when the purchaser at a defective foreclosure sale in good faith, takes possession of the premises, he may retain such possession as mortgagee in possession until the obligation secured by the mortgagee is fulfilled." [2] When the mortgagee is in possession, he must use, manage, and preserve the premises or property in a reasonably prudent manner. For example, if a mortgagee in possession of a lumber business fails to see that disbursements are properly made and the accounts are kept with reasonable prudence, he is liable for any resulting loss.[3]

Rents and Profits. The mortgagee ordinarily is not entitled to the rents and profits of the mortgaged premises, unless they by express agreement are also pledged to secure the obligation. The mortgagor may use or dispose of the rents and profits free from the claims of the mortgagee. This right is allowed, as a matter of public policy, to encourage productivity and, as a matter of fairness, to assure remuneration to the mortgagor for the work done.

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[1] §2—(2).
[2] §2—(3).
[3] *Steward* v. *Traverse City State Bank*, 168 Mich. 258, 134 N. W. 196.

There are two exceptions to the general rule stated above. If the mortgagee has lawful possession, he is entitled to collect the rents and profits. Indeed the mortgagee when in possession is under a duty to use reasonable diligence in collecting the rents and to use reasonable prudence in management in the creation of profits. Failure to exercise such diligence or prudence renders him liable for losses due to such a cause. The mere fact that the mortgagee reduces rents or that the premises are vacant is not alone sufficient to establish liability for such losses. For example, the vacancy may be due to some act on the part of the mortgagor.[4]

> A mortgagee in possession was charged with the fair rental value of the property during the time he allowed it to remain unoccupied. (Humrick v. Dalzell, 113 N. J. Eq. 310, 166 A. 511)

The mortgagee, when entitled to the rents and profits, is under a duty, after payment of necessary repairs and taxes, to apply them to the mortgage debt and to turn over any surplus to the mortgagor. "The reason underlying the rule requiring a mortgagee in possession to account for the rents and profits is that the mortgage does not entitle him to possession, and the profits of the possession are consequently received by him as a trustee for the mortgagor and not for himself." [5] The mortgagee is also entitled to have the rents and profits applied to the payment of the mortgage debt which exists when the property has been placed in the hands of a receiver.

Repairs and Improvements. In the absence of an agreement to the contrary, a mortgagor is under no duty to make improvements or to restore or repair such parts of the premises which are destroyed or injured without negligence on his part. If, however, he is guilty of waste or allows deterioration, his conduct may justify the appointment of a receiver.[6]

The mortgagee, when in possession, must make reasonable and necessary repairs in order to preserve the estate. He is

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[4] *La Forest* v. *W. L. Blake Co.*, 100 Me. 218, 60 A. 899.
[5] *Anglo-Californian Bank* v. *Field*, 154 Calif. 513, 98 P. 267.
[6] *Post*, p. 817.

entitled, however, to reimbursement for all proper expenditures on the ground that they inure to the benefit of the mortgagor. Ordinarily the mortgagee may not charge to the mortgagor expenditures for valuable or enduring improvements. "A contrary holding under such circumstances would mean that at his discretion a mortgagee can put improvements upon real estate to such an extent as to render it impossible for the mortgagor to redeem. His additions might vastly enlarge the value of the land, but prevent redemption by the mortgagor for wants of funds to meet the increase though he might be able to pay the original debt." [7]

> " 'What is a proper expenditure must depend upon the circumstances of each case.' " (Fidelity Trust Co. v. Saginaw Hotels Co., 259 Mich. 254, 242 N. W. 906)

An improvement which is necessary for the preservation of the premises comes under the classification of repairs for which compensation can be claimed. To illustrate, when an old boiler in an operating plant cannot be repaired, the purchase of a new one is justified.[8] The Chattel Mortgage Act authorizes the mortgagee to add to the principal debt any outlay necessary to preserve the goods or security, unless there is an express stipulation to the contrary.[9]

Taxes, Assessments, and Insurance. The duty to pay taxes and assessments rests upon the mortgagor when he is in possession. A mortgagee in possession is usually under a duty to pay taxes and assessments out of the rents and profits. In the absence of an agreement, neither party is under a duty to insure the mortgaged property. Both parties, however, are entitled to take out insurance to protect their respective interests.

> A stipulation requiring a mortgagor to keep the buildings insured "against loss or damages by fire for an amount not less than none dollars," did not obligate the mortgagor to insure the buildings. (Suttles v. Vickery, 179 Ga. 751, 177 S. E. 714)

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[7] *Caro* v. *Wollenberg*, 83 Oreg. 311, 163 P. 94.
[8] *Hays* v. *Christiansen*, 105 Nebr. 586, 181 N. W. 379.
[9] §27—(3).

If the mortgagor fails to perform the duty of paying taxes, assessments, or insurance premiums, the mortgagee is entitled to make such payments and to receive reimbursement therefor. The Uniform Mortgage Act gives this right to a purchaser during the period of redemption.[10] The Chattel Mortgage Act provides that "the mortgagee may, unless the contrary is expressly provided, pay any taxes on the subject matter and any insurance premiums not paid by the mortgagor." [11] Such payments, however, are treated as future advances and must be recorded as prescribed to be valid against certain creditors and purchasers without notice.

Impairment of Security. The mortgagor is liable in damages to the mortgagee for any injury to the property, due to his fault, which impairs the security of the mortgage. He may be enjoined from committing any acts of waste or spoliation in respect to the mortgaged property. For example, the mortgagee is entitled to an injunction to restrain the removal of fixtures, timber, or machinery when such a removal impairs or tends to impair the security.[12] The Uniform Mortgage Act expressly gives the remedy of damages and injunction to the mortgagee in the case of the impairment of security, and to the purchaser at foreclosure in the case of waste.[13] The Chattel Mortgage Act provides that "if the mortgagor, without consent of the mortgagee, shall substantially injure the goods, or conceal or purport to sell or otherwise dispose of them or any substantial part of them under claim of full ownership, or otherwise by his willful neglect substantially impair the value of the agreed security, save so far as is consistent with reasonable use of the goods, such action shall constitute a default." [14] The impairment of security by fraudulent injury, concealment, sale, or removal on the part of the mortgagor is sometimes made a criminal act.[15]

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[10] §33.
[11] §27—(3).
[12] *Anderson* v. *Englehart*, 18 Wyo. 409, 108 P. 977.
[13] §§3 and 22.
[14] §21.
[15] *Chattel Mortgage Act*, §22.

The mortgagor may be restrained from opening up new mines "on the ground that the removal of the ore from the ground constitutes impairment of the security." (Kremer v. Rule, 209 Wis. 183, 244 N. W. 596)

The mortgagee, whether or not he is in possession, is liable to the mortgagor for injuries to the property due to his fault. Both the mortgagor and the mortgagee have a right of action against a third person who wrongfully injures the property. In some states the mortgagor loses this right after the mortgagee takes possession.

Transfer of Interest. The mortgagor may transfer his interest in the property, but the transfer may under the terms of the mortgage constitute a default. The Chattel Mortgage Act provides that a default occurs in some instances in which there is a removal of the goods, or a transfer of interest, without the consent of the mortgagee, or without at least ten days' written notice of the destination or of the transferee.[16] In the absence of statute the consent of the mortgagee to a transfer is unnecessary, except when the mortgagor desires to transfer the premises free from encumbrances.

The sale of the mortgaged property does not ordinarily affect the rights of the mortgagee against the property, or the personal liability of the mortgagor to meet the obligation secured. "There can be no change in the relationship between the mortgagor and the mortgagee, without the knowledge and consent of the mortgagee, which can affect the rights of the mortgagee." [17]

A mortgagor cannot by any conveyance of the property "relieve himself from the obligation of paying the indebtedness." (Seale v. Berryman, 46 Ariz. 233, 49 P. [2d] 997)

The purchaser of mortgaged property does not become personally liable for the debt secured, unless he assumes it. Even when the purchaser assumes the debt, the mortgagor continues liable unless released by the mortgagee. If the purchaser assumes liability for the debt, the mortgagee, after notice thereof, must treat the mortgagor as a surety to the

[16] §20—(2); also, §§21 and 22.
[17] *Peters* v. *Lindley*, 88 Okla. 32, 211 P. 409.

extent that as a general rule he must do nothing which will injure the mortgagor's interest. To illustrate, if the mortgagee after notice and without the mortgagor's consent releases the transferee from personal liability or releases part or all the property from the mortgage lien, the mortgagor is discharged entirely or partially.[18]

QUESTIONS

1. Scrope brought suit against Glendower to recover possession of eighty acres of land. At the trial Scrope produced a deed from Glendower conveying the property to him. Glendower proved, however, that the instrument was given merely as a mortgage. Was Scrope entitled to judgment?

2. Harrison mortgaged his farm to secure payment of a sum of money borrowed from Oliver. At the time of receiving the mortgage, Oliver took possession of the farm with the consent of Harrison. Thereafter, without having paid the debt, Harrison brought an action against Oliver to recover possession of the property. Was he entitled to do so?

3. Border borrowed five thousand dollars on a note from Lollard and executed a mortgage on two adjoining farms as security for payment of the note. Border rented one farm to Humphrey and lived on the other. Lollard contended that he was entitled to the rent from the one farm and the profits from the other. Was his contention sound?

4. Eardly, who held a mortgage on a tract of land, was permitted by the mortgagor to take possession of the property. Thereafter the mortgagor demanded that Eardly turn over to him all the rents and the profits. Was the mortgagor entitled to the rents and the profits?

5. Creighton issued a note for seven hundred dollars payable to Stuart, and he executed a mortgage on a two-story apartment building to secure the payment of the debt. Three years before the maturity of the note the building was struck by lightning and destroyed by fire. Stuart contended that Creighton was under a duty to restore the building. Do you agree?

6. The owner of a given piece of land executed a mortgage on it to secure the payment of several notes. The mortgagee, with consent of the mortgagor, took possession of the property. While in possession, the mortgagee expended four hundred dollars in clearing brush and timber from the land while preparing it for cultivation. He then claimed credit for this expenditure. Was he entitled to credit for this amount?

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[18] *Jordan* v. *Bullard*, 145 Ga. 890, 90 S. E. 41.

7. A mortgagor in possession of the mortgaged premises fails to pay the taxes on the property. In order to save the property from a tax sale, the mortgagee pays the back taxes. He now contends that he is entitled to reimbursement for this amount. Is his contention sound?

8. A mortgagee contends that the mortgagor is under a duty to insure the mortgaged buildings against loss by fire, on the ground that he is unable to take out insurance on the property. The mortgagor contends that the duty of insuring the property rests upon the mortgagee. Do you agree with either of the parties?

9. Carlyle executed a mortgage on a certain parcel of land and a dwelling house thereon to secure the payment of twenty-three hundred dollars. Later Carlyle took out and carried away the water fixtures, water pipes, bathroom fixtures, and gas pipes. The mortgagee brought a tort action against Carlyle to recover damages for injuries to the mortgaged property. Was he entitled to judgment?

10. Perin destroyed a barn on a farm because he did not like Fuller who owned the property. Simpson, who held a mortgage on the farm, brought a tort action against Perin to recover damages for injuries to the mortgaged property. Was he entitled to judgment?

11. Corbett purchases a piano, making a part payment and executing a mortgage on the article for the additional payments of the purchase price. Later Corbett sells his interest in the property to Bennett. How does this transaction affect the mortgagee's right to hold the property, if it affects the right at all?

12. Carrigan owned a three-hundred acre farm valued at thirty thousand dollars, which he mortgaged to secure a loan of five thousand dollars. After several seasons of poor crops Carrigan decided to move to the city. He thereupon conveyed the land to Hilger for a purchase price of twenty-five thousand dollars. The loan was not paid at maturity. Was the mortgagee entitled to hold either Carrigan or Hilger personally for the amount of the debt?

Part III—Rights and Duties of Mortgagee

Recording or Filing of Mortgage. As between the mortgagee and the mortgagor or one succeeding to the rights of the latter, a mortgage, otherwise valid, is ordinarily not affected by the mortgagee's failure to record or file it. To illustrate, the heirs, devisees, or executor of the mortgagor are usually bound by an unrecorded mortgage.[1] Statutes in most states, however, require that mortgages be filed or recorded to be valid against bona fide purchasers or creditors without notice.

> "As between the parties, a mortgage is valid without registration, but not so as to creditors." (Ellington v. Raleigh Building Supply Co., 196 N. C. 784, 147 S. E. 307)

A mortgage must usually be recorded in the county in which the property is located. The time within which a mortgage must be filed varies in the different states. In some states a mortgage is valid against everyone if it is recorded within a prescribed period. This renders it impossible for a purchaser to discover from the record during such period whether there is an existing lien which will be given preference. In other states a mortgage is effectively recorded only as of the time of actual registration, or of delivery to the proper officer for filing. The Chattel Mortgage Act adopts the latter view, declaring that "no failure of the filing officer, after he has received possession of the instrument or document, to perform the duties required of him by this Act shall affect the validity of such filing, except as against a person who has by himself or his agent become a party to suppression or falsification of the record." [2]

Transfer of Interest. In most states a mortgage may be transferred or assigned by the mortgagee. A few states, following the common-law or legal theory of mortgage, hold that a mortgage is nonassignable at law and that the title of the mortgagee can be transferred only by a formal conveyance. The assignability of mortgages, however, has always

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[1] *McBrayer* v. *Harrill*, 152 N. C. 712, 68 S. E. 204.
[2] §46—(2).

been recognized by the court of equity. Although an equitable assignment requires that only the intent of the parties be shown, there must be as a general rule a written assignment in order to pass a legal title. Formal assignment is sometimes required by statute, and it is usually necessary for recording purposes.

> "A bond and mortgage which is personal property may be assigned by delivery without a written instrument." (Drobney v. Sullivan, 148 Misc. 670, 266 N. Y. S. 245)

A transfer of the mortgage without the debt may, under the common-law theory, pass the legal title, but the transferee holds it in trust as security for the debt. In states following the lien theory a transfer of the mortgage without the debt is usually treated as a nullity. Thus one court says, "A mortgage is mere security for the debt, and it cannot pass without a transfer of the debt." [3] The Chattel Mortgage Act provides, in respect to an assignment of a mortgage, that "the mortgagee may at any time assign his interest and such assignment shall be construed, in the absence of express provision to the contrary, to constitute an assignment of the obligation secured to the extent of the value of the goods." [4]

A common form of equitable assignment, which is sometimes recognized at law, is the transferring of the debt. The mortgage is considered incidental to the debt and is carried with it. This view is frequently prescribed by statute.[5] When a portion of the debt is assigned, the rights of the parties to the security generally depend upon their agreement. The Chattel Mortgage Act declares that "the assignment of a portion of any obligation secured by a mortgage shall constitute the assignor to that extent the trustee of the assignee with respect to the mortgage." [6]

When the mortgage secures a debt evidenced by a negotiable instrument, the holder in due course in most states takes the mortgage free from defenses available to the mortgagor as against the mortgagee. This view is adopted by both uni-

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[3] *Johnson* v. *Regy*, 181 Calif. 342, 184 P. 657.
[4] §28—(a).
[5] *Chattel Mortgage Act*, §28—(b).
[6] §28—(2).

form mortgage acts. The Uniform Mortgage Act states that "a mortgage securing a negotiable instrument is free from any defenses from which the obligation secured by the mortgage is free by reason of its negotiable character, subject, however, to the effect of recording acts." [7]

Receiver before Foreclosure. The mortgagee is entitled to the appointment of a receiver when one is necessary for the protection of the property. For example, when the mortgagor is guilty of waste which impairs or jeopardizes the security, a court of equity at the request of the mortgagee will appoint a receiver.[8] In some states a receiver will be appointed upon a showing that the security is inadequate and that the mortgagor is insolvent. The right of receivership under such circumstances is an exception to the rule previously stated that the mortgagor, while the mortgagee is not in possession, is entitled to the rents and profits.

> A receiver is not entitled to the rents and profits accruing prior to the time he takes possession. (Silurian Oil Co. v. Essley, 54 F. [2d] 42)

The Uniform Mortgage Act states that "when an action or proceeding has been commenced to foreclose a mortgage, a receiver of the mortgaged premises may be appointed upon application of the mortgagee at any time prior to the sale, if it appears that the security is clearly inadequate, or that the premises are in danger of being materially injured or reduced in value as security, by removal, destruction, deterioration, accumulation of prior liens or otherwise, so as to render the security inadequate." [9] The proceeds arising during a receivership must be used in preserving and restoring the premises and in paying the debt. Any surplus must be turned over to the mortgagor.

The Uniform Mortgage Act also provides that the mortgagee may assume the duties of a receiver when the mortgagor abandons the premises and the facts justify the appointment

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[7] §7.
[8] *Hardin* v. *Hardin*, 34 S. C. 77, 12 S. E. 936.
[9] §4—(1).

of a receiver. This is an original provision to save expense and delay, especially in case of small mortgages. No provision, however, is made as to the penalty for a wrongful entry on the part of the mortgagee. An improper entry may frequently happen, since the question whether given circumstances justify a receiver is a question of fact.

Performance of Obligation. The mortgagee is entitled to the performance of the obligation secured by the mortgage within a reasonable time or at or before the date fixed. When the obligation is a debt, its payment should be made to the mortgagee or to an agent authorized to receive payment. A mortgagee need not accept payment from a stranger but any person succeeding to the rights of the mortgagor or having an interest to protect may pay the debt. For example, payment may be made by an executor, heir, or widow of the mortgagor, or by a second mortgagee.[10]

> "'A note payable to two creditors jointly, may be paid by paying either, and when paid to either, a mortgage to secure its payment is extinguished.'" (Mathews v. De Foor, 172 Ga. 318, 158 S. E. 7)

The effect of a valid tender varies in the states. Some courts hold that a tender on the due date does not discharge the lien. Most courts hold that it does when it is arbitrarily or unreasonably refused. The debt, however, in such a case is not discharged. The courts are also in conflict as to whether or not a tender after default relieves the property of the lien. The Uniform Mortgage Act adopts the rule that it does not of itself discharge the lien of the mortgage.[11] The same rule is adopted by the Chattel Mortgage Act, but with the qualification that "after due tender the deposit of the amount tendered to the credit of the mortgagee in a solvent bank or trust company or the payment of such amount into court, followed by due giving of notice of such deposit or payment to the mortgagee, shall discharge the mortgage."[12]

If the debt is in any way discharged, the mortgage is also discharged. A discharge of the debtor from personal liability,

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[10] *Tyrell* v. *Ward*, 102 Ill. 29.
[11] §5.
[12] §24—(2).

however, does not release the lien of the mortgage. Thus the discharge of the mortgagor in bankruptcy does not affect the lien of the mortgage.[13] An express release by the mortgagee or one succeeding to his rights may discharge the mortgage.

Satisfaction. The mortgagee, after receiving satisfaction of the debt, is under a duty to give the mortgagor evidence that the mortgage has been discharged. This duty may be enforced by various actions in the different jurisdictions. Statutes usually require the filing of a discharge or an entry of satisfaction in the margin of the record when the mortgage has been recorded.

The entry or certificate must be in the form required by statute. If no particular form is required, the entry or certificate should show a release by the party entitled to payment and should especially identify the mortgage. In some states, witnesses to the release are required. The mortgagee is required in some states to pay the cost of entering the satisfaction of record, but the parties are allowed to provide otherwise by agreement.

In many states, statutes impose a penalty upon the mortgagee for wrongful failure to give the necessary evidence of the discharge of the mortgage. They also frequently give the mortgagor a right to recover damages under such circumstances. The Chattel Mortgage Act requires that a statement of discharge be given by the mortgagee to the mortgagor, and "if for ten days after such demand the mortgagee fails to mail or deliver such a statement of discharge, he shall be liable for all damages suffered thereby; and except in the case of discharge under section 24-2 (by deposit in bank after tender) shall forfeit to the mortgagor ten per cent of the maximum amount of the obligation secured during the life of the mortgage; where such maximum exceeds three thousand dollars the mortgagee shall forfeit three hundred dollars or two per cent of such maximum, whichever is greater." [14]

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[13] *Burtis* v. *Wait*, 33 Kans. 478, 6 P. 783.
[14] §26—(2).

QUESTIONS

1. Hopkins brings a suit to foreclose a mortgage on a given house and lot two years after the death of the mortgagor. Donnelley, who occupies the premises, contests the suit. He proves that the mortgagor devised the property to him by a valid will which had been duly probated. He also proves that the mortgage on which the suit is based had not been recorded. Is Hopkins entitled to maintain the foreclosure proceedings?

2. Spitzer issues a note for twelve hundred dollars payable to Berger. He also executes a mortgage on his farm to secure payment of the instrument. Berger sells the note to Fowler. The note is unpaid at maturity, and Fowler claims that he is entitled to foreclose on the mortgage. Do you agree?

3. Reardon holds a note that is secured by a mortgage on an apartment building owned by Walker. He assigns the mortgage to Melton, keeping the note himself. When the note is not paid at maturity, Melton contends that he is entitled to foreclose the mortgage. Do you agree?

4. Mellquiest borrows twenty-two hundred dollars on a negotiable promissory note from Devries and executes a mortgage on an apartment house to secure payment of the note. Devries negotiates the instrument to Wanstrom. On nonpayment of the note at maturity Wanstrom brings proceedings to foreclose on the mortgage. Mellquiest's defense is that he paid the debt to Devries when it was due. Is this a valid defense?

5. Mowbray brought proceedings to foreclose a mortgage on a given farm. Later he applied for the appointment of a receiver of the mortgaged premises. At the hearing Mowbray proved that the mortgagor had felled several fruit trees on the premises and had removed the water pipes from the house. Was he entitled to an appointment of a receiver?

6. Maxwell, who had mortgaged his home, abandoned the premises when the mortgagee brought proceedings to foreclose the mortgage. The vacant house was in danger of deterioration, but the mortgagee believed that the appointment of a receiver would be too expensive. Could the mortgagee assume the duties of a receiver himself?

7. McGrew executes a mortgage on a radio set to secure payment of two hundred dollars which he borrows from Hasco. Two months before the debt is due, McGrew is killed by a fall in an airplane. Three months later Hasco seeks to foreclose the mortgage. Watkins, to whom McGrew had bequeathed his household goods, claims that the mortgage is discharged. He proves that a tender of the debt was made by him when the debt was due. Is Hasco entitled to a decree of foreclosure?

8. Kirk borrows five hundred dollars from the Security Finance Company and executes a mortgage on his automobile to secure payment of the debt. At maturity Kirk is unable to pay the amount due. A week later he makes a tender of payment to the company, which is refused. Does this tender release the property from the mortgage?

Part IV—Rights after Default

Right to Redeem. The right of redemption means the right of the mortgagor to free the property of the mortgage lien, although the term is ordinarily used to indicate the right to do so after default. At common law the rights of the mortgagor ceased upon his failure strictly to perform the obligation secured, and title to the property vested absolutely in the mortgagee. This frequently resulted in a forfeiture, because in many instances the value of the security was much greater than the debt.

At an early date the court of equity recognized the hardship which this method of enforcing the security imposed upon the debtor or mortgagor. It was felt that the creditor or mortgagee was entitled only to his principal plus interest, and no more. The court of equity, taking this point of view, announced the doctrine that the mortgagor was entitled to redeem the property within a reasonable time after default by paying the principal debt and interest. In time the right of redemption became an integral and inseparable part of every mortgage. For example, an agreement by the mortgagor to waive his right of redemption is against public policy and is unenforceable.[1] Courts feared that the mortgagor, in signing an agreement of this kind upon the request or demand of the mortgagee, might have acted under a greater or lesser degree of economic duress.

> When a statutory right of redemption was waived, the court declared that "independent of the statute there is in equity a right to redeem." (Shinn v. Barrie, 182 Ark. 366, 31 S. W. [2d] 540)

In equity the right of redemption exists until foreclosure. By statutes in many states, however, the right may be exercised during a certain time following foreclosure and sale. The Uniform Mortgage Act provides for redemption by the mortgagor within one year after sale, and by subsequent lienors, such as a second mortgagee, during a short period thereafter in case the mortgagor does not redeem.[2] The Uniform Chattel

[1] *Turpie* v. *Lowe*, 114 Ind. 37, 15 N. E. 834.

Mortgage Act provides for a redemption period of ten days before a sale, except when goods are of a perishable nature, or when the mortgagor gives twenty days' notice "of intention to take possession and bar reinstatement or discharge." [3] In general, redemption may be made only by a person whose interests will be affected by foreclosure. Thus the right to redeem rests with the executor or the heirs of the mortgagor, and in most states with a second mortgagee.[4]

Right to Foreclose. *Foreclosure* is the remedy of the mortgagee to subject the property mortgaged to the satisfaction of the obligation for which it was given as security. It derives its name from the fact that it cuts off the mortgagor's equity of redemption. The development of the right to foreclose naturally followed the recognition of the right of redemption. The court of equity, although feeling that the mortgagee should not be allowed to take the property as a forfeiture upon default and that the mortgagor should be allowed to redeem upon performance of the obligation, came to the conclusion that in fairness to the mortgagee the mortgagor should exercise his right of redemption within a reasonable time after default. The court therefore permitted the mortgagee to bring a suit, the effect of which was to set a specific time within which the mortgagor might redeem. His failure to redeem within the time set operated as a forfeiture or foreclosure of his equity of redemption.

> "An action to foreclose a mortgage is peculiarly an equitable action." (Brand v. Woolson, 120 Conn. 211, 180 A. 293)

The right to foreclose as a general rule rests in the mortgagee or the one who is beneficially interested in the performance of the obligation. Thus the executor of the mortgagee, or the assignee of the mortgagee or of the debt secured, is entitled to exercise the right of foreclosure.[5] When the property mortgaged is to secure a debt evidenced by more than

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[3] §§55 and 57.
[4] *Newall* v. *Wright*, 3 Mass. 138.
[5] *Lewis* v. *Stocke*, 18 Miss. 120.

one instrument, there is a conflict of authority as to the rights of the parties. These rules have been previously considered.[6]

The right to foreclose, like the right to redeem, must be exercised within a reasonable time. A reasonable time is ordinarily measured by equity as the period of time which is necessary to create an adverse title. This period is usually prescribed by statute at present; it varies in the different states from four years to twenty-one years. The Uniform Mortgage Act prescribes that "at the expiration of a period of fifteen years from the last definite date of maturity of the debt or other obligation secured by a mortgage as stated therein, or in an extension thereof duly executed and recorded as herein provided, and if no definite date for any maturity be stated therein, then at the expiration of a like period from the date of the mortgage or extension, the lien of the mortgage shall cease and no suit or proceedings shall be begun thereafter to foreclose the mortgage." [7] The Uniform Mortgage Act allows an extension of the lien only by a renewal of record, expressly denying an extension "by other agreement, non-residence, disability, partial payment or otherwise." [8]

The result of a foreclosure in most states is to free the property of all junior liens, or, in other words, of those liens which have attached subsequently. For example, a second mortgagee, if made a party to the proceedings, is barred in most states by foreclosure.[9] Foreclosure also extinguishes the obligation to the extent of the value of the property. In case the value of the property is less than the debt secured, the mortgagee is entitled to a deficiency judgment for the remainder against the person owing the obligation, who is usually, but not necessarily, the mortgagor.

Strict Foreclosure. The proceeding in equity to bar the mortgagor's equity of redemption terminated after the latter's default during the time set for redemption, by vesting title to the property absolutely in the mortgagee. The court of equity, in other words, gave a decree of foreclosure only and

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[6] *Ante*, p. 803.
[7] §12—1.
[8] §12—2.
[9] *Rose* v. *Walk*, 149 Ill. 60, 36 N. E. 555.

did not direct a sale of the property. The effect was to cut off the right of the mortgagor or one claiming under him and to vest his estate or interest absolutely in the mortgagee. This procedure came to be known as *strict foreclosure*, and at one time was the only method of foreclosure.

Strict foreclosure was not favorably received in this country. The procedure, although allowing time for a redemption, was still looked upon as inequitable, in so far as it frequently permitted the mortgagee to receive in satisfaction of his debt property having value greatly in excess of the debt. Accordingly in many states the right to strict foreclosure is denied by courts or by statutes. In other states, courts may in their decree allow it when it seems just under the particular circumstances of a given case. For example, strict foreclosure is allowed in some states when it is manifest that the property mortgaged is insufficient to pay the debt secured.[10] In this situation, courts feel that there is no reason for adding the expense of a sale when the mortgagor will not be deprived of any surplus value. As one court says, "To warrant a decree of strict foreclosure, where the practice permits such foreclosure, the evidence should show that the interests of both parties require it." [11]

Foreclosure by Sale. The ordinary method of foreclosure in this country requires a sale of the property at the direction of a court. Proceedings for this purpose are instituted by a suit in equity or by a similar statutory action in a court of law. The nature of the suit or action is partly in rem, in that it is directed against the property, and partly in personam, in that it involves the rights of the mortgagor, against whom a deficiency judgment may be rendered. The validity of the foreclosure may be questioned by any subsequent lienor or by the mortgagor. Thus a foreclosure may be restrained upon a showing that the debt has been paid, that proper parties have not been joined, or that there are other matters which render foreclosure inequitable.[12]

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[10] *Hitchcock* v. *U. S. Bank*, 7 Ala. 386.
[11] *Nevin* v. *Lulu, etc., Mining Co.*, 10 Colo. 357, 15 P. 611.
[12] *Davis* v. *Flagg*, 35 N. J. Eq. 491.

> "Equity will not allow a mortgagee to foreclose a mortgage for a mere technical default." (Gibraltar Finance Corporation v. Rouse, 145 Oreg. 89, 25 P. [2d] 559)

The proceedings to a foreclosure ordinarily must be brought by the mortgagee or the person having the beneficial interest in the security, and others jointly interested. In case the latter do not join as plaintiffs, they should be joined as defendants so that their claims may be adjudicated at the same time. The mortgagor and all others whose rights will be affected by the foreclosure should ordinarily be joined as defendants. Thus subsequent lienors, such as a second mortgagee, should be joined.[13] If these parties are not joined, their right to redeem, when it is possible to redeem only before the sale, continues. On the other hand, prior lienors or parties with claims superior to the mortgagee are not proper parties to the proceedings, as their interests are not affected by the foreclosure.

> "In foreclosure actions prior incumbrancers are not necessary parties, as the land may be sold subject to their liens, but they may be made parties to have the amount due them liquidated." (Clark v. Fuller, 136 Misc. 151, 239 N. Y. S. 348)

The ordinary procedure in the hearing or trial is settlement by the court of the priority of all claims, and other questions such as the amount of the mortgagor debt. During this time a receiver may be appointed to conserve the property, rents, and profits.

After the preliminary questions have been settled, a decree, ordering a sale of the property to satisfy the mortgage debt, is rendered. If the mortgagor has conveyed the property in parcels to others, the latter are entitled to demand that the last part alienated be sold first, so that if the proceeds of such sale are sufficient to pay the debt, the previously alienated parts will not be disturbed. The sale must be made in a proper manner and must usually be confirmed by the court. Confirmation will be denied if fraud, misconduct, or other irregularities in the sale are shown. For example, a sale

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[13] *Harris* v. *Hooper*, 50 Md. 537.

will not be confirmed if it is shown that notice of the sale was not properly given.[14]

The sale may be set aside even after confirmation upon a showing of irregularities in the sale or of statutory causes. A petition to vacate the sale, however, must be made in due time after confirmation of the sale. In some cases the right to question a sale must be exercised within a specified period of time. The Uniform Mortgage Act provides that "no such sale shall be held invalid or set aside unless the action of defense in which its validity is called in question be commenced or interposed before the purchaser has gone into possession of the premises under a duly recorded certificate of sale and has occupied the same for three successive years and paid the current taxes thereon during such period, or has without possession paid the current taxes thereon under such recorded certificate for five successive years during which time the premises have not been occupied by the mortgagor. This period of limitation shall not be extended by any disability." [15]

The proceeds of the sale are used to pay any taxes due and then to satisfy the claims of the mortgagee. If there is a surplus, it is turned over to the mortgagor or to creditors having liens. If the proceeds of the sale of the property do not satisfy the mortgage debt, the mortgagee is entitled in most states to receive a deficiency judgment for the remainder against the debtor.

Power of Sale. A provision in a mortgage authorizing the mortgagee to sell the mortgaged property upon default without resorting to a judicial proceeding is known as a *power of sale.* In most states such powers are permissible either by common law or by statutes. The Chattel Mortgage Act provides for the sale of goods after the period of redemption by the mortgagee in the manner permitted an unpaid vendor.[16]

In the absence of statute or agreement the sale may be private or public. The mortgagee cannot ordinarily purchase at a sale under a power of sale. The Chattel Mortgage Act expressly permits him to purchase when the sale is at public auction.

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[14] *Miller* v. *Lefever*, 10 Nebr. 77, 4 N. W. 929.
[15] §§30 and 35-A.
[16] §58.

This is also allowed by the Uniform Mortgage Act which requires a sale by auction under such power. Statutes usually require proper notice of sale. The Uniform Mortgage Act specifies the contents of such notice, and requires publication thereof once in each of three successive weeks, and mailing of the notice to each person known to have an interest.[17]

> Although statutory requirements with respect to notice of sale must be complied with, a notice with respect to time of sale reciting "Monday June 9" without the year was held to be sufficient because it was not likely to mislead. (Holzman v. Bristol County Sav. Bank, 277 Mass. 383, 178 N. E. 622)

Courts have not been uniform in their decisions as to whether the death of the mortgagor revokes the power. In jurisdictions in which the legal theory prevails, the power clearly cannot be revoked. Courts in some states, particularly those taking the lien theory of a mortgage, hold that the power to sell is not coupled with such an interest as to preclude revocation by the death or disability of the mortgagor. The Uniform Mortgage Act states that "the death, insanity or other disability of a mortgagor, or any transfer or sale of the premises by him, occurring subsequent to the execution of the mortgage, shall not revoke or suspend a power of sale therein." [18]

Special Statutory Foreclosures. Although most statutory methods of foreclosure involve proceedings similar to those in a suit in equity for a foreclosure by sale, or a foreclosure under reserved power of sale, there are a few statutes providing for foreclosure methods which closely resemble those in a strict foreclosure.

By Entry. In a few eastern states the mortgagee, after a default, is entitled by statute to enter and take possession of the premises. The entry may be with the consent of the mortgagor, or without his consent, if it is made peacefully. In the latter event the entry must be in the presence of witnesses who are required to make a certificate as to the nature of the entry.

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[17] §§15, 16, and 17.

This certificate must be filed for record. Thus, "entry by the mortgagee for condition broken, in the presence of two witnesses, and a certificate thereof duly sworn to before a justice of the peace, and duly recorded, are all that is necessary to effect a foreclosure." [19] A valid certificate must specifically set forth facts about the time, manner, and purpose of the entry. After entry and retention of possession for a specified time, the mortgagee gains absolute title.

By Writ of Entry. In most of the states allowing foreclosure by entry, the mortgagee may gain possession by means of a writ of entry which involves a proceeding similar to that of foreclosure in equity. A judgment is rendered to the effect that if the debt is not paid within a certain period, the mortgagee will be placed in possession. Aside from the fact that the mortgagee may be given possession in opposition to the wishes of the mortgagor, and aside from the fact that the merits of the claim are judicially settled prior to entry, the proceeding is similar to that of foreclosure by entry.

By Notice. In one state at least, foreclosure may be made without entry and possession by the mortgagee. The statute may provide for foreclosure by publication or service of notice. The notice must contain a clear statement of the essential elements of the mortgagee's claim and of his intention to foreclose. Thus, "the notice must describe the premises so intelligibly, that those entitled to redeem may know, with reasonable certainty, what premises are intended." [20] The notice when published must appear a certain number of successive times in proper newspapers. A copy of the notice must be filed for record within a prescribed period following publication or service. The foreclosure is completed if the mortgagor or persons succeeding to his rights do not redeem within a period of one year after notice is properly given.

Action on Debt. In case of default a mortgagee, in the absence of statute or agreement, is not required to foreclose, but he may pursue any other remedy which he possesses. He

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[19] *Ellis* v. *Drake*, 8 Allen (Mass.) 161.
[20] *Chase* v. *McLellan*, 49 Me. 375.

may, for example, bring an action on the debt, recover judgment, and proceed as any judgment debtor by execution to seek satisfaction of the debt. The fact that he has elected to foreclose does not preclude him from pursuing another remedy. In fact the mortgagee "may employ as many remedies as the law gives him provided they are not inconsistent with each other. He may sue on the debt alone, and may obtain an attachment or other proceeding authorized by law to establish his debt or to secure or enforce its payment, or he may foreclose the mortgage and subject the mortgaged property to the payment of the debt. The mere fact that he has asked for a foreclosure does not preclude the use of other concurrent and consistent remedies." [21]

In some states the common-law rule has been modified in respect to the right to pursue other remedies in order to prevent multiplicity of suits and needless expense. For example, the statute may provide that a foreclosure must precede an action on the debt, or it may provide that a foreclosure of a purchase-price mortgage shall alone be appropriate for getting satisfaction of the debt.[22] When the mortgagee may pursue several remedies concurrently, he is, of course, entitled to only one satisfaction.

QUESTIONS

1. Radke executed a mortgage on his farm to secure the payment of a debt which Greenwood owed to Marshall. The debt was not paid at maturity. Marshall contended that the title to the property vested absolutely in him on the failure of Greenwood to perform. Was his contention sound?

2. Jackson lends eleven hundred dollars to Schoen on a promissory note. The latter executes a mortgage to secure the debt and agrees to waive his right of redemption. Schoen fails to pay the note when due, but he offers to pay it ten days thereafter. Jackson refuses to accept the money on the ground that Schoen waived his right of redemption. Schoen contends that the agreement is unenforceable. Do you agree?

3. "The development of the right to foreclose naturally follows the recognition of the right of redemption." What is meant by this statement?

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[21] *Hodge* v. *Roy*, 102 Kans. 197, 169 P. 1143.
[22] *Clarke* v. *Paddock*, 24 Ida. 142, 132 P. 795.

4. Leach executes a mortgage on a vacant lot to secure payment of a note issued by Alco. Alco fails to perform the obligation when due. Twenty-five years later the mortgagee brings a suit to foreclose the mortgage. Is he entitled to a decree?

5. Shinn holds a first mortgage on Kraft's property to secure payment of a note for two thousand dollars. Hayes holds a second mortgage on the same property to secure a debt which matures five years before the note held by Shinn becomes due. Hayes forecloses on his mortgage after Kraft has been in default for some time. How does this foreclosure affect Shinn's rights, if at all?

6. "Strict foreclosure, although allowing a reasonable time for redemption, is ordinarily an inequitable procedure." What is meant by this statement?

7. A mortgagee brings a suit in equity, petitioning for a foreclosure sale of certain mortgaged property. At the trial the mortgagor offers evidence to prove that the debt secured by the mortgage has been paid. Should this defense be admitted?

8. Ruel executed a mortgage on a given tract of land. He then conveyed a parcel representing one eighth of the land to Wright. Later he conveyed another parcel of the same size to Becker. When the debt was not paid, the mortgagee brought a suit to foreclose on the entire tract, including the part conveyed to Wright. Wright contended that the mortgagee had to satisfy the debt out of the parcel purchased by Becker before resorting to the land which Wright purchased. Was his contention sound?

9. Slocum executes a mortgage on his garage. A provision in the mortgage authorizes the mortgagee to sell the mortgaged property upon default, without resorting to a judicial proceeding. After Slocum's death the heirs contend that the power of sale granted to the mortgagee is revoked. Is the mortgagee entitled to exercise the power?

10. It is contended that all statutory methods of foreclosure involve proceedings similar to those in a suit in equity for a foreclosure by sale, or foreclosure under reserved power of sale. Do you agree?

11. Carson is the holder of a note secured by a mortgage on Meyers' apartment hotel. Upon default Carson brings a proceeding to foreclose. A few days later he brings action against the maker to recover on the note. The maker defends the action on the ground that foreclosure proceedings are then pending. Is this a valid defense?

CASES FOR REVIEW

1. W. P. Coffman executed a mortgage on a tract of land to Eldridge and Richardson. A second mortgage on the land was executed in favor of the Chickasaw Cooperage Company. The first mortgage was foreclosed, and the proceeds of the sale were more than required to pay the debt secured by the first mortgage. J. M. Jackson, a creditor of Coffman, brought an action to subject the surplus money to his claim. The cooperage company contended that the surplus money should be applied to the payment of its debt. Was Jackson entitled to judgment? (Jackson v. Coffman, 110 Tenn. 271, 75 S. W. 718)

2. Robert D. Clark and others sold certain land to William H. Colehour, who executed a mortgage to secure payment of the purchase price. Colehour conveyed parts of the land to Lewis D. Boone, Dayton S. Morgan, and others. The mortgagees, although under no duty to do so, paid the taxes on the land that were due and unpaid by the mortgagor. In an action to foreclose the mortgage, it was contended by the mortgagees that they were entitled to add the amount of the taxes paid by them to the mortgage debt. Do you agree with this contention? (Boone v. Clark, 129 Ill. 466, 21 N. E. 850)

3. Henry and Lizzie Fuller gave to the American Trust Company a mortgage on eighty acres of land to secure payment of two specified notes "or any indebtedness of whatever sort or nature that may be due from the mortgagors to the mortgagee at the time of foreclosing" the mortgage. Alex Berger purchased the claim of the bank and took an assignment of the mortgage. Thereafter he foreclosed the mortgage, not only for the debt owed by the mortgagors to the trust company, but also for all other debts due him arising out of other and separate transactions. Was he entitled to do this? (Berger v. Fuller, 180 Ark. 372, 21 S. W. [2d] 419)

4. Peter Fish and James T. Young executed and delivered to Henry T. Glover a note for $8,000 secured by a mortgage on a certain coal mine. Thereafter they transferred their interest in the property to Thompson, who promised the mortgagors that he would pay the amount of the mortgage debt. Glover brought an action against Fish and Young to recover on the note. Was Glover entitled to judgment? (Fish v. Glover, 154 Ill. 86, 39 N. E. 1081)

5. Fred Pritchett executed and delivered a note for the sum of $2,272.97 to Edwin Jarl, of Osceola, Iowa. He also gave a mortgage on certain land to secure the payment of the instrument. In an action brought by Jarl against Pritchett on the note, it was contended that under the common law separate actions on the note and on the mortgage could be maintained at the same time. Do you agree? (Jarl v. Pritchett, 190 Iowa 1268, 179 N. W. 945)

6. G. H. Brown was the owner of certain land in Spink County, South Dakota. He executed a deed conveying the land to W. H. Brown,

who transferred his interest in the property to Z. P. Mustar. The deed was given to W. H. Brown by G. H. Brown as security for a debt. Edwin McComb obtained a judgment against G. H. Brown and executed a levy on the land to satisfy the judgment. In an action brought by Mustar to restrain the action of McComb, it was contended that the deed should be treated as a mortgage. Do you agree? (Mustar v. McComb, 40 S. D. 205, 167 N. W. 232)

7. Joe Flathers executed and delivered a negotiable note, and a mortgage to secure the payment thereof, in favor of G. A. Lanaux, a commission merchant. Lanaux negotiated the note to the State National Bank, a holder in due course. In an action brought by the bank to enforce the mortgage, Flathers sought to set up as a defense an equity that he had against Lanaux. Was he entitled to do so? (State Nat. Bank v. Flathers, 45 La. Ann. 75, 12 S. 243)

8. Whitehouse and his wife executed a second mortgage to Raymond to secure a note for the sum of $60. Thereafter they executed a third mortgage to Hamilton to secure the sum of $600. Raymond foreclosed the second mortgage but did not make the holders of the first and third mortgages parties to the suit. Did the purchaser at the foreclosure sale take the property free from the liens of the first and third mortgages? (Raymond v. Whitehouse, 119 Iowa 132, 93 N. W. 292)

9. J. M. Brown executed a mortgage on a quarter section of land to secure payment of an indebtedness of $2,500 owed to M. W. Kales. Possession of the land was taken by Kales in good faith under a defective foreclosure sale. He sold his interest to J. T. Sims, who in turn sold his interest to George T. Brasius. In an action brought by T. J. Bryan, Brasius, who had the rights of Kales, contended that he was entitled to possession of the land until the debt was paid. Do you agree with this contention? (Bryan v. Brasius, 3 Ariz. 433, 31 P. 519)

10. O'Brien was arrested for a felony and held to bail for the sum of $10,000. Samuel Nelson, in order to induce Dennis Moloney to become a surety and unite with him in the execution of the bail bond, gave a mortgage on certain property to Moloney as security against a loss due to a default on the part of O'Brien. Was there an obligation here that might be properly secured by a mortgage? (Moloney v. Nelson, 158 N. Y. 351, 53 N. E. 31)

11. Don A. Gillet executed and delivered to John Romig a note for the sum of $700, secured by a mortgage on certain land in Garfield County, Oklahoma. Gillett thereafter by deed conveyed the land, subject to the mortgage, to Myrtle Gillett. Romig took possession of the land in good faith under a defective foreclosure and transferred his interest to Daniel W. Harding. During subsequent litigation, it was contended that Romig and Harding, who took Romig's rights, were under a duty to account for the rents and the profits. Do you agree? (Gillett v. Romig, 17 Okla. 324, 87 P. 325)

12. Spotswood Garland executed a mortgage in favor of Douglas H. Gordon to secure a loan of $20,000. The mortgage contained a provision that authorized the mortgagee to sell the property upon default. Thereafter, in an action brought by David H. Carroll and another against A. H. Taylor, it was contended that the death of the mortgagor did not terminate the power to sell given to the mortgagee. Do you agree with this contention? (Taylor v. Carroll, 89 Md. 32, 42 A. 920)

13. The Cook-Reynolds Company was the owner of certain land. It mortgaged the land and the rents and profits therefrom to secure the payment of an obligation. The land was conveyed, subject to the mortgage, to Milton R. Wise, who in turn made a similar conveyance to Edna W. Keller. In an action brought by Alice O. Hastings against Wise and another, to foreclose the mortgage, it was contended that in the absence of a statute to the contrary rents and profits were proper subjects of a mortgage. Do you agree? (Hastings v. Wise, 89 Mont. 325, 297 P. 482)

14. William T. Ellison mortgaged to Carlo Tordello a certain quarter section of land to secure the payment of a note for $1,000. Thereafter Ellison mortgaged the same land to T. M. Jones to secure the payment of the sum of $2,000. The mortgage to Tordello was not recorded, but Jones knew of its existence when he took the second mortgage. When Tordello brought an action against Ellison and Jones to foreclose his mortgage, Jones contended that he had a superior right under his mortgage. Was his contention sound? (Tordello v. Ellison, 132 Wash. 20, 231 P. 9)

15. The Braehead Coal Mining Company executed a mortgage to the West Blocton Savings Bank to secure payment of an indebtedness of $16,120. The mortgage covered two mining leases, machinery, and other equipment for the operation of a coal mine. The bank obtained possession of the property and incurred expenses in providing coal for the operation of boilers to furnish power to the pumps used to keep water out of the mine and in making repairs to the boilers. During litigation between the bank and a surety on a bond, the bank contended that upon an accounting it was entitled to the foregoing expenses. Do you agree? (Fidelity & Deposit Co. v. West Blocton Sav. Bank, 216 Ala. 465, 113 S. 489)

16. Blake was obligated to pay a debt evidenced by a note in favor of Nolly Waldren. The debt was secured by a mortgage on a lot in the city of Anderson, Indiana, executed by George Begein and his wife. Blake thereafter became a bankrupt. In an action brought by Mary M. Begein against Philip Brehm, it was contended that since Blake, as the result of the bankruptcy, was not liable on the note, the mortgage was discharged. Do you agree? (Begein v. Brehm, 123 Ind. 160, 23 N. E. 496)

CHAPTER XV

LANDLORD AND TENANT

Part I—General Considerations

Introduction. The relation of landlord and tenant was of outstanding importance in economic society during the development of the early common law. The rules, standards, and principles governing this relation doubtless formed the most important part of the civil law in days when feudalism was at its height. The decline of the feudal tenure system produced no change in this respect, since England continued to be essentially a nontrading nation. It was not until trade and commerce developed that the relation of landlord and tenant lost its relative importance. The attention given by courts to other increasingly important relations at this time did not, however, indicate that the relation of landlord and tenant was delegated to a minor role. It still played an important part in economic society, although significant rivals (growing out of the expansion of industry) were increasing rapidly. The same forces which brought about a new economic life required a change, sometimes drastic, in the principles, standards, and rules governing the relation of landlord and tenant.

The relation of landlord and tenant is of considerable importance to the man in business. Most businesses require the possession or ownership of real property. For more or less obvious reasons, almost every person engaged in business occupies the position of tenant. Less frequently, persons occupy the position of landlord. In either case a person engaged in business activities should have some appreciation of the principles of law dealing with the many questions arising out of the relationship in question, particularly those which center around the rights and duties of the tenant, and the rights and duties of the landlord.

Definition. The relation of *landlord* and *tenant* exists whenever one person occupies the land of another under an express or implied agreement. The person who permits the

occupation of the premises is known as the *landlord.* The *tenant* is "one who occupies land or the premises of another in subordination to the other's title, and with his assent, expressed or implied." [1] The landlord and the tenant are also commonly known as the *lessor* and the *lessee* respectively.

> The word "landlord" may "mean a person of either sex or even an artificial person." (In re Heartman's Will, 178 Misc. Rep. 730, 35 N. Y. S. [2d] 685)

Several elements are necessary in the establishment of the relation of landlord and tenant. First, the occupation must be with the express or implied consent of the landlord. For example, an occupancy by a trespasser does not create the relation.[2] Second, the tenant must occupy the premises in subordination to the rights of the landlord. To illustrate, even though the owner allows a person to occupy his land, the relation is not established if that person claims ownership of the property.[3] Third, a reversionary interest in the land must remain in the landlord. Fourth, the tenant must have an estate in the land. Finally, possession and control of the premises must be given to the tenant.

Classification of Tenancies. Tenancies, in terms of the size of the estate created, are divided into four classes.

Tenancy for Years. A tenancy for years is one under which the tenant has an estate of definite duration. The term *for years* is descriptive of such tenancies, whether the duration of the estate is for a period less or more than a year. To illustrate, a party holding an estate in land for a period of ten weeks, ten months, or ten years holds under a tenancy for years.[4]

Tenancy from Year to Year. A tenancy from year to year is one under which a person, holding an estate in land for an indefinite period of duration, pays an annual rent. A distinguishing feature of this tenancy is the fact that it does not

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[1] *Krug* v. *Davis*, 101 Ind. 75.
[2] *Langford* v. *Green*, 52 Ala. 103.
[3] *McKee* v. *Howe*, 17 Colo. 538, 31 P. 117.
[4] *Brown* v. *Bragg*, 22 Ind. 122.

terminate at the end of a year, except upon proper notice. In almost all states a tenancy from year to year is implied if the tenant, with the consent of the landlord, holds over after a term for years. Although it must be clear in such cases that the landlord has not elected to treat the tenant as a trespasser, recognition of the tenancy may be shown by the conduct of the landlord. For example, his consent to the holding over may be implied by the fact that he accepted rent for a period beyond the old period.[5]

Tenancy at Will. When land is held for an indefinite period, which may be terminated at any time by the landlord or by the landlord and the tenant acting together, a tenancy at will exists. Courts are not in agreement as to whether the relationship is a tenancy at will or a life estate when its termination rests exclusively with the tenant. This form of tenancy may be created by express or implied agreement. Statutes in some states and decisions in others require advance notice of the termination of this type of tenancy.

Tenancy by Sufferance. When a tenant holds over without permission of the landlord, the latter may treat him as a trespasser or as a tenant. Until he elects to do one or the other, a tenancy by sufferance is said to exist. It terminates when the landlord ejects the tenant or recognizes his possession as rightful.

Creation of the Relation. The relation of landlord and tenant is created by an express or implied contract. A parol lease is valid at common law, but statutes in most states require written leases for certain tenancies. Many statutes follow the English Statute of Frauds which provides that a lease for a term exceeding three years shall be in writing.[6] Statutes in other states require written leases when the term exceeds one year. Some courts apply to leases the provision of the Statute of Frauds which states that an agreement not to be performed within the space of one year from its execution shall be in writing.[7]

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[5] *Laurens Tel. Co.* v. *Enterprise Bank*, 90 S. C. 50, 72 S. E. 878.
[6] *29 Car. 11*, ch. 3, §§1-3.
[7] *Ibid.*, §4—(5).

This Lease Witnesseth:

THAT Beatty Warner, does
HEREBY LEASE TO Charles J. Foster
the premises situate in the City of Saint Paul is the County of Ramsey and State of Minnesota described as follows:
Dwelling House, No. 1900 West Liberty Street, Saint Paul, Minnesota
with the appurtenances thereto, for the term of three years commencing January 1, 19__, at a rental of Seventy-five
dollars per month, payable monthly.

SAID LESSEE AGREE S to pay said rent, unless said premises shall be destroyed or rendered untenantable by fire or other unavoidable accident; to not commit or suffer waste; to not use said premises for any unlawful purpose; to not assign this lease, or under-let said premises, or any part thereof, or permit the sale of his interest herein by legal process, without the written consent of said lessor; to not use said premises or any part thereof in violation of any law relating to intoxicating liquors; and at the expiration of this lease, to surrender said premises in as good condition as they now are, or may be put by said lessor reasonable wear and unavoidable casualties, condemnation or appropriation excepted. Upon non-payment of any of said rent for ten days, after it shall become due, and without demand made therefore; or the bankruptcy or insolvency of lessee or assigns, or the appointment of a receiver or trustee of the property of lessee or assigns or if this lease pass to any person or persons by operation of law; or the breach of any of the other agreements herein contained, the lessor may terminate this lease and re-enter and re-possess said premises.

SAID LESSOR AGREE S (said lessee having performed his obligations under this lease) that said lessee shall quietly hold and occupy said premises during said term without any hindrance or molestation by said lessor, his heir or any person lawfully claiming under them.

Signed this first day of January A. D. 19__.

IN PRESENCE OF:

William F. Hummel — Beatty Warner
W. L. Peace — Charles J. Foster

State of Minnesota, County of Ramsey, ss.

This day, before me, a Notary Public in and for said County, personally came Beatty Warner and Charles J. Foster

the parties to the foregoing Lease, and acknowledged the signing thereof to be their voluntary act.

WITNESS my hand and official seal this first day of January A. D. 19__.

L. H. Hashamp
Notary Public

LEASE

"Oil and gas mining leases" are transfers of interests in land such as contemplated by Section 4 of the Statute of Frauds, hence all such "leases" must be evidenced by a writing. (Harris v. Tucker, 147 Okla. 210, 296 P. 397)

A contract creating the relation of landlord and tenant is implied when the intent to establish such relation may be inferred from the conduct of the parties. The tenant's entry under a void lease is an illustration of conduct from which a tenancy may be inferred. As a general rule a tenancy from year to year is implied when the tenant goes into possession under an oral lease and pays rent, if the oral lease is for a period covered by the Statute of Frauds. Statutes, however, often prescribe the effect of noncompliance with the requirement of a written lease. For example, they may prescribe that under the circumstances the relation is a tenancy at will [8] or that a tenancy from year to year [9] is created.

The Lease. The contract establishing the relation of landlord and tenant is known as a *lease*. It is in effect a conveyance of a leasehold estate in land. In accord with this point of view, a lease has been defined as "a conveyance by the owner of an estate to another of a portion of his interest therein, for a term less than his own in consideration of a certain annual rent or other recompense." [10]

"An agreement for a lease, to be executed later, is not a demise, and does not create the relation of lessor and lessee." (Blair v. Lux, 256 Mich. 463, 240 N. W. 54)

The term *lease* is also used to designate the instrument which is evidence of the contract. Ordinarily, a lease need not be in any particular form of language, provided it is clear and definite, showing an intention to transfer possession of the premises. A formal lease usually contains (1) an identification of the parties, (2) a description of the premises, (3) a designation of the term during which the tenancy is to exist, (4) a statement as to the amount and the manner of payment of the rent, (5) a statement of covenants and conditions, if

[8] *Davis* v. *Thompson*, 13 Me. 209.
[9] *Railsback* v. *Walke*, 81 Ind. 409.
[10] *Gray* v. *LaFayette County*, 65 Wis. 567, 27 N. W. 311.

any, and (6) the signatures of the parties. If a statute, as is sometimes the case, prescribes certain requirements for a valid lease, the provisions thereof must, of course, be followed. In some states a lease for a certain term must be under seal, witnessed, acknowledged, and recorded.

QUESTIONS

1. "With the development of trade and commerce the relation of landlord and tenant became unimportant in economic life." Do you agree with this statement?

2. Henderson is the owner of certain property with improvements, consisting of a theater and a hotel. He leases the premises to Price. The terms of the lease prohibit any transfer without the consent of the landlord. Henderson consents to an assignment of the lease to a partnership composed of Freeman and Allen. Later Clevenger enters into the partnership. Clevenger now claims that the relation of landlord and tenant exists between Henderson and him. Do you agree?

3. Boyd takes possession of Cochran's land and claims it as his own. At the end of a year Cochran demands rent for the use of the premises, but Boyd refuses to pay. Is Cochran entitled to a landlord's remedy to recover rent?

4. Galvin and Russell own adjoining land. Galvin cultivates forty acres of Russell's land. When Russell discovers the trespass, he refuses to allow Galvin on the premises. Galvin claims a tenant's privilege of removing the crops. Is he entitled to this privilege?

5. Calin agrees to perform certain duties around the house and to care for Mrs. Herbst until death, in consideration of a warranty deed executed by the latter, conveying certain property to him. The deed contains the following clause: "The grantor, reserving a life estate with all the rights of possession and control during her lifetime." Calin moves upon Mrs. Herbst's premises. Later Mrs. Herbst becomes insane, and a conservator is appointed by the court who brings an action to eject Calin from the premises. Calin's defense is that he having performed his agreement is entitled to possession as a tenant. Do you agree?

6. The City Hotel Company and The Taxi-Cab Auto Service Company entered into an agreement under which the latter was given the privilege of a stand for touring cabs and taximeter cabs for a period of three years in consideration of fifteen hundred dollars a year. One year later The City Hotel Company revoked its consent to the stand in front of the hotel and made a similar arrangement with the General Taxicab Company. The Taxi-Cab Auto Service Company brought suit for an injunction against The City Hotel Company. It contended that it was a tenant under a lease. Was this contention sound?

7. Bevan was the owner of a six-family apartment building. The janitor received as compensation a certain salary and the use of certain rooms in the basement for himself and wife. The mother-in-law of the janitor became ill while visiting him and was compelled to leave the building by Bevan who feared that the infectious disease would endanger the tenants. The mother-in-law brought an action for damages against Bevan. Bevan's liability depended upon whether the janitor was a tenant. Was the plaintiff entitled to judgment?

8. Lundy wishes to use a given piece of property owned by Gill. The latter leases the property to him until he finds a purchaser. What form of tenancy is created by this agreement?

9. Jackson leases Hillier's house and lot for a period of twelve months. Jackson contends that he holds the property under a tenancy for years. Hillier contends that Jackson holds under a tenancy from year to year. Do you agree with Jackson or Hillier?

10. "A tenancy by sufferance is created by express agreement." Do you agree with this statement?

11. Carroll owned a farm which contained six hundred and forty acres. He entered into an oral agreement with Featherstone, whereby he leased the farm to Featherstone for a period of ten years. Subsequently Carroll refused to give possession to Featherstone. Was the agreement enforceable?

12. Jameson, who owned a tract of land, agreed to execute a lease thereof on the first day of the following month to Kronaugh. Did this transaction create the relation of lessor and lessee between the parties?

Part II—Rights and Liabilities of Tenant

Right of Possession. By making a lease, the landlord impliedly covenants that he will give possession of the premises to the tenant at the agreed time. If the lease is obtained by fraud or if the tenant does not perform a condition precedent to the vesting of the estate, the landlord may rightfully withhold possession. The lessee's failure to perform any other agreement does not justify a refusal of possession. The lessor cannot withhold possession merely because the lessee has met financial reverses, although this may be indicative that the lessee cannot long continue to make regular payments of rent.[1]

> "During the term (of the lease) the tenant is substantially the owner of the property, having the right of possession, dominion, and control over it." (Hannan v. Dusch, 154 Va. 356, 153 S. E. 824)

The lessee is entitled to damages for the lessor's refusal to give possession, and he is generally allowed to bring an action to recover possession. He may, however, accept possession at a date later than that fixed by the terms of the agreement, or he may accept possession of a part of the premises. In either case he is entitled to such damages as he has suffered, unless he waives his rights to them. On the other hand, in neither case is the tenant under any obligation to take possession. "He may stand upon his contract and recover damages for the breach. . . . He cannot be compelled to take any pay for less than he contracted for, but he may take less, if he sees fit to do so, and recover damages by way of compensation for what he cannot get." [2]

Eviction. An *eviction* exists when the tenant is deprived of the possession, use, and enjoyment of the premises by the interference of the landlord or one acting under him. An eviction may be total or partial. If the landlord wrongfully deprives the tenant of the use of one room when he is entitled

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[1] *Blanc's Cafe* v. *Corey*, 118 Wash. 10, 202 P. 266.
[2] *Huntington Easy Payment Co.* v. *Parsons*, 62 W. Va. 26, 57 S. E. 253.

to the use of the whole building, there is a partial eviction.[3] An eviction may also be actual or constructive. It is said to be constructive when some act or omission of the landlord substantially deprives the tenant of the use and enjoyment of the premises. It is essential in a constructive eviction that the landlord intend to deprive the tenant of the use and enjoyment of the premises. This intent may, however, be inferred from the results of his conduct. The tenant must also abandon the premises. "The propositions that there can be retention of demised premises, and an eviction, are logically and legally contradictory. The position has not the slightest warrant in law, principle, sense or decisions. There are cases in which it has been deemed that there was an eviction without a forcible ouster. But in such cases the tenant abandoned and the court held, that acts of the landlord were so illegal and monstrous, as to be equivalent to absolute physical ouster." [4]

> A tenant oil company, not having been in possession of the premises, "could not be evicted from that which it never possessed." (Port Utilities Commission v. Marine Oil Co., 173 S. C. 346, 175 S. E. 818)

A tenant who has been evicted may in proper action recover possession of the premises, or damages for the eviction, or both. The landlord, however, is not liable for the acts of others unless they are his agents. If the eviction is by one gaining possession through a title paramount to that of the landlord, the latter is usually liable for damages under an implied or express covenant for quiet enjoyment.

Rent. The tenant is under a duty to pay rent. Rent has been defined legally as "the compensation which the occupier pays the landlord for that species of occupation which the contract between them allows." [5] The compensation may be in the form of services, chattels, or money. The liability of the tenant arises out of an express or implied agreement.

Under the common law the destruction of the premises does not as a general rule relieve the tenant of liability to pay rent. "The reason for this severe rule is that the land is

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[3] *Moore* v. *Mansfield*, 182 Mass. 302, 65 N. E. 398.
[4] *Mortimer* v. *Brunner*, 19 N. Y. Super. 653.
[5] *Regina* v. *Westbrook*, 10 Q. B. 178.

deemed the subject of the demise, and the buildings a mere incident." [6] Some courts have refused to apply this rule when the tenancy involved merely a building or space therein. The lease may contain an agreement by the parties that liability for rent shall cease in case the premises are destroyed or merely injured. In many states, statutes have been enacted modifying the general rule of the common law.

> "Section 2297 of the statutes (of this state) was passed to relieve the tenant from having to pay, in the absence of an express agreement to the contrary, the rent, if the demised premises were destroyed by fire." (Winter v. Taylor, 224 Ky. 827, 7 S. W. [2d] 209)

The time of payment of rent is ordinarily fixed by the lease. When the lease does not control, rent, generally speaking, is not due until the end of the term. Statutes or custom, however, may require rent to be paid in advance even when the agreement of the parties does not control. When the lease is assigned, the assignee is liable to the lessor for the rent. The assignment, however, does not per se discharge the lessee from his obligations under the lease. The lessor may bring action for the rent against either the lessee or the assignee, or both, but he is entitled only to one satisfaction. A sublessee ordinarily is not liable to the original lessor for rent, unless he assumes such liability or unless the liability is prescribed by statute.

Use of Premises. In the absence of express or implied restrictions, a tenant is entitled to use the premises for any purpose for which they are adapted or for which they are ordinarily employed. He is under an implied duty to use the premises properly even when the lease is silent as to the matter. What constitutes proper use of the premises depends, in the first place, upon the wording of the lease. For example, it has been held that if land is leased for agricultural purposes, the lessee is not entitled to use it for mining.[7] The lease may, of course, and frequently does, prescribe a certain mode of use which must be observed by the tenant.

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[6] *Waite* v. *O'Neil*, 76 F. 408.
[7] *Kingston* v. *Lehigh Valley Coal Co.*, 236 Pa. 350, 80 A. 820.

A provision in a hotel lease prohibiting the use of a room adjoining the lobby for any business other than a restaurant was violated by the use of the space for a courtroom of a justice of the peace. (Collins v. Truman, 223 Mo. A. 186, 14 S. W. [2d] 526)

The tenant is also under an implied duty to use the premises for lawful purposes. Another implied duty of the tenant is to refrain from willful or permissive waste. At common law the tenant is entitled to cut sufficient timber for fuel and for repairs to fences, buildings, and farm implements. "The rigid rule of the common law that a tenant of a particular estate could not cut timber, except for estovers, is in many jurisdictions modified so as to allow him to clear as much of the estate as the needs of his family may require for their support, though the timber be destroyed thereby. And he may clear for cultivation such portions of it as a prudent owner in fee would clear for that purpose, provided he leaves enough timber and wood as may be necessary for the permanent use and enjoyment of the inheritance. His right to open and clear for cultivation wild and uncultivated land is that of a prudent owner, having regard to its amelioration as an inheritance." [8]

Improvements and Repairs. In the absence of special agreement, neither the lessee nor the lessor is under a duty to make improvements. Either may, however, make a covenant for improvements, in which case a failure to perform will render him liable in an action for damages brought by the other party. In the absence of an agreement to the contrary, improvements which are attached to the land become part of the realty and belong to the lessor. The lessor may, of course, agree to pay for the improvements made by the lessee. When the tenant is allowed to remove the improvements, some courts hold that he must remove them before the end of the term, whereas others permit a removal within a reasonable time thereafter. The rights of the parties as to the removal of improvements are sometimes regulated by statute.

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[8] *Warren County* v. *Gans*, 80 Miss. 76, 31 S. 539.

> "'A tenant may remove from the demised premises at any time during the continuance of his term anything affixed thereto for purpose of trade, manufacture, ornament or domestic use, if the removal can be effected without injury to the premises, unless the thing has, by the manner in which it is affixed, become an integral part of the premises.' Section 8555, C. O. S. 1921." (Scrivner v. Pope, 143 Okla. 246, 289 P. 311)

In the absence of agreement to the contrary, the lessee's failure to make minor repairs renders him liable for permissive waste. "A tenant is bound not only to commit no waste, but to make fair and tenantable repairs, necessary to prevent waste and decay of the premises." [9] When the lessor leases only a portion of the premises, or leases the premises to different tenants, he is under a duty to make repairs in connecting parts, such as halls, basements, and stairways, which are under his control. In some states there are statutes requiring that proper repairs be made by the lessee or the lessor, or both. To illustrate, some statutes require that a lessor, who leases a building for dwelling purposes, must keep it in condition fit for habitation.[10]

Assignment and Sublease. An *assignment* is a transfer by the lessee of his entire interest in the premises to a third person. A tenancy for years may be assigned by the lessee, unless he is restricted from doing so by the terms of the lease or by statute. The lease may contain provisions denying the right to assign or imposing specified restrictions on the privilege of assigning. Such restrictions are enforceable. "Restrictions against assignments without the consent of the lessor are valid for various reasons. Among them is that a lessor has the right to exercise his judgment with respect to the persons to whom he trusts the management or custody of his premises. Naturally he does not want undesirable tenants, those who may use his property for unlawful purposes, or those whom he may consider financially irresponsible." [11]

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[9] *Smith* v. *Chappell*, 25 Pa. Super. 81.
[10] *Torreson* v. *Walla*, 11 N. Dak. 481, 92 N. W. 834.
[11] *In re Lindy-Friedman Clothing Co.*, 275 F. 453.

The giving of a mortgage on a lease does not violate a covenant against assignment contained in the lease. (Chapman v. Great Western Gypsum Co., 216 Calif. 420, 14 P. [2d] 758)

A *sublease* is a transfer of the premises by the lessee to a third person for a period less than the term of the lease. The rules governing assignment are also applicable to subletting. In both cases, restrictions are construed liberally in favor of the lessee. An ineffectual attempt to assign or sublet does not violate a provision prohibiting such acts. This is equally true when another is merely permitted to use the land. As a general rule a transfer of all or part of the premises by operation of law is not a breach of such conditions. As one court says: "It is well settled that an assignment by operation of law passes the estate discharged of the covenant to the assignee; and this would seem to be so where the transfer arises from voluntary proceedings in insolvency, as distinguished from proceedings in invitum, and where there is no indication that the proceedings are colorable, merely for the purpose of effecting the transfer in fraud of the lessor." [12] There may, however, be a provision in the lease which gives the lessor the right to avoid the lease in such case.

QUESTIONS

1. Kerns had been negotiating a lease of his premises to Bailey. He was falsely told by Hazelton that Bailey stated that he did not wish to use the property. Kerns thereupon executed a lease to Hazelton. When Kerns learned of the deception, he refused to give possession of the premises to Hazelton. The latter thereupon brought an action to recover possession. Was he entitled to judgment?

2. Arnold executes a lease of the second story of his apartment building to Bates. The latter is to be given possession on May 1. Arnold does not offer possession of the apartment until June 1, and then he retains possession of one room. Bates enters into possession and brings an action for damages. Is he entitled to judgment?

3. Rae was a tenant occupying a house owned by Stiles. During a heated political argument the latter became enraged at the former and decided to drive him from the premises. He thereupon caused ill-smelling fumes to pervade the property occupied by Rae. The

[12] *Bemis* v. *Wilder*, 100 Mass. 446.

situation became so intolerable that it was impossible for Rae to live comfortably on the premises. He refused to move, however, and brought an action to recover damages for eviction against Stiles. Was Rae entitled to recover?

4. Henning leased a farm which was situated on a primary coast-to-coast highway. Shortly after he moved upon the premises, a group of tourists ousted him and took possession of the farm. Henning complained to the landlord, but the latter took no action to remove the trespassers. Henning thereupon brought an action against the landlord for damages. Was he entitled to judgment?

5. Henderson leased a ranch from Fernald for a period of one year and immediately took possession of the premises. Fernald called a few days later and demanded payment of the rent. Henderson refused to pay the rent, and Fernald brought an action to recover the agreed amount of rent. Was he entitled to recover?

6. Putnam and Lowell execute a lease whereby the latter is given possession of a piece of land containing three hundred and sixty acres. The lease provides that the property is to be used for grazing purposes. After taking possession, Lowell begins to clear the brush and rocks from the land for the purpose of growing crops. Putnam contends that he is not entitled to do this. Do you agree?

7. "A sublease is a transfer by the lessee of his entire interest in the premises to a third person." Do you agree with this statement?

8. A tenant felled some growing trees for fuel, although at the time there was sufficient dead wood on the premises for that purpose. He also sold some trees which he had felled for making repairs, and he purchased with the funds some timber which he intended to use for that purpose. The landlord contended that the tenant was guilty of waste. Was his contention sound?

9. Horr leased a given piece of land for a period of five years. When he took possession, there were a house and two barns on the premises. After purchasing an automobile, Horr demanded that the landlord construct a garage to house the machine. The landlord contended that he was under no duty to do so. Do you agree?

10. A landlord and tenant are discussing the condition of the leased premises. The former urges the tenant to make certain repairs. The latter points out that there is nothing in the agreement requiring him to make repairs and contends that he is therefore under no duty to do so. Is his contention sound?

Part III—Rights and Duties of Landlord

Care of Premises. In the absence of a covenant to keep the premises in repair, the landlord is ordinarily not liable to the lessee for personal injuries caused by the defective condition of the premises which are by the lease placed under the control of the tenant. In other words, the lessor, as a general rule, makes no implied warranty as to safeness. He is, however, liable to the tenant for injuries caused by latent defects of which he had knowledge. For example, when the landlord had knowledge that the leased premises were infected with a contagious disease, and failed to warn the lessee of the fact, the tenant was permitted to recover for damages sustained through occupation of the premises.[1] In some states the landlord is liable for defects which he might have discovered with due care. When the landlord agrees to make repairs, some courts hold that the tenant may recover for injuries received. Other courts hold that he has only a right of action for breach of contract.

> A statute requiring a landlord to keep tenement house in repair, although applying to kitchen stoves attached in the usual way to the building, was held not to apply to movable ice boxes furnished by the landlord. (Israel v. Toonkel, 134 Misc. Rep. 327, 235 N. Y. S. 285)

Liability for injuries follows control. The tenant in complete possession is therefore answerable to licensees and to invitees for lack of proper care, whether or not the landlord is under a duty to make repairs. If, however, the landlord retains control over a portion of the premises, he is liable for injuries caused by his failure to exercise proper care in connection with that part of the premises. Thus, "a landlord who rents different parts of a building to various tenants and retains control of the stairways, passageways, hallways, or other methods of approach to the several portions of the building for the common use of the tenants, has resting upon him an implied duty to use reasonable care to keep such places in a reasonably safe condition, and that he is liable for in-

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[1] *Cesar* v. *Karutz*, 60 N. Y. 229.

juries which result to persons lawfully in the building from a failure to perform such duty." [2]

Transfer of Interest. The reversionary interest of the landlord may be transferred involuntarily as in a sale by receiver, executor, or sheriff. The landlord may also voluntarily grant or assign his reversionary interest. Under the common law an assignment does not transfer the rights of the landlord as against the lessee, unless the latter *attorns* to the assignee. "The doctrine of attornment grew out of the peculiar relations existing between the landlord and tenant under the feudal law. The landlord could not alienate the estate without the consent of his tenant. This consent was called an attornment." [3] The necessity of attornment was later abolished by statute,[4] the provisions of which have been re-enacted in this country or adopted by courts as a part of the common law.

> The transferee of the landlord's reversionary interest "is charged with the terms of the lease, and is bound by them." (Woodcock v. Pope, 154 Md. 135, 140 A. 76)

When the landlord assigns his reversion, the assignee is, in the absence of an agreement to the contrary, entitled to subsequent accruals of rent. The rent may, however, be reserved in an assignment of a reversion. The landlord may also assign the lease independent of the reversion, or the rent independent of the lease. In the event of an assignment of the rent or of the reversion, notice thereof must be given to the tenant. If the tenant, in good faith and without notice of the assignment, pays the rent to the assignor, he is discharged of his liability therefor. After notice of the assignment, the tenant acts at his peril in making payments to any person other than the assignee or his agent.

Taxes and Assessments. In the absence of an agreement to the contrary, the lessee, except possibly in case of unusually long-term leases, is not under a duty to pay taxes or assess-

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[2] *Payne* v. *Irwin*, 144 Ill. 482, 33 N. E. 756.
[3] *Perrin* v. *Lepper*, 34 Mich. 291.

ments. If the tax or assessment, however, is chargeable to improvements made by the lessee which do not become a part of the property, the lessee is liable therefor. When the lessee pays taxes or assessments to protect his interests, he may recover the amount, including damages, from the lessor, or withhold the amount from the rent. Statutes frequently provide a remedy under which either the lessee or lessor may recover taxes or assessments paid by one party for the other.

> "If a lease is silent as to who shall pay the taxes on the real property, the obligation rests on the landlord." (Pacific Palisades Assn. v. Menninger, 219 Calif. 257, 26 P. [2d] 303)

The lessee may agree to pay all or a certain portion of the taxes or assessments. Such promises are often found in leases. If the agreement is to pay all taxes and assessments, the lessee is liable only for such as become a charge during his term, unless it is otherwise agreed. When the lessee agrees to pay the taxes only, he is, of course, not liable for special assessments. For example, under such an agreement, the lessee is under no duty to pay an assessment for street improvements or for the construction of a sewer.[5] Likewise, when the lessee agrees to pay the assessments only, he is not liable for general taxes.

When the premises are assigned, the assignee is bound by the covenants of the lessee to pay taxes and assessments. Such covenants are said to "run with the land." The fact that the assignee is bound by the covenants does not, however, discharge the lessee from liability. A sublessee is not bound by the covenants of the lessee, but may expressly assume them. In the latter case, however, the lessee is not discharged from his covenants.

Lien. The landlord at common law does not have a lien upon the crops or personal property of the tenants for money due him for rent. The parties may, however, by express or implied contract create a lien in favor of the landlord. By agreement, of course, the lien may be created for claims other

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[5] *Ittner* v. *Robinson*, 35 Nebr. 133, 52 N. W. 846.

than for rent. To illustrate, a lien may be created by agreement for advances, taxes, or damages for failure to fulfill a duty of making repairs.[6]

> An agreement for a landlord's lien on all hotel fixtures thereafter acquired and placed in a hotel by the lessee was held valid. (Harbour-Longmire Co. v. Reid, 124 Okla. 77, 254 P. 29)

Statutes in many states provide for a lien in favor of the landlord on the personal property or the crops of the tenant. These statutes vary as to the time when the lien attaches and as to its duration. They also vary as to the indebtedness covered by the lien. To illustrate, the statute may give the lessor a lien for rent and other charges, or for the rent alone.[7] These statutes are strictly construed. It follows that the obligation for which a lien is claimed must clearly come within the provisions of the statute. This is equally true as to the property to which the lien attaches. A given statute may specify that certain property only, such as crops, furniture, or goods, or that all the property of the tenant, shall be subject to the lien. In the former case no lien is allowed on property not clearly within the class specified. For example, it was held that the term *effects* in a provision specifying "goods, furniture, and effects" meant goods of a kind similar to those designated by the preceding words, and it therefore did not give a lien on a mule.[8]

In the absence of a statutory provision, the lien of the landlord is superior to the claims of all other persons, except prior lienors and bona fide purchasers without notice. His lien may, however, be lost in several ways. First, he may lose it because he has misled third parties as to his intention to enforce the lien. Second, he may lose the lien by consenting or authorizing a sale or removal of the property. Finally, he may expressly or impliedly waive his lien.

Distress. The common law authorizes the landlord in case of nonpayment of rent to seize personal property found on

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[6] *Von Berg* v. *Goodman*, 85 Ark. 605, 109 S. W. 1006.
[7] *Ladner* v. *Bailey*, 103 Iowa 674, 72 N. W. 787.
[8] *McKleroy* v. *Cantey*, 95 Ala. 295, 11 S. 258.

the premises and hold it until the arrears are paid. This right is known as *distress.* It is not an action against the tenant for rent, but merely a right to retain the property as security until the rent is paid.

The right of distress arises only upon nonpayment of rent and is not available as security for any other claim. For example, the landlord cannot distrain (levy a distress) for a claim for damages due to a breach of covenant relating to the use of the premises.[9] The parties may, however, increase the powers of the landlord in respect to time of distraining, to the property subject thereto, or to the manner of its exercise. Another limitation on the right of distress is that there must be an express or implied agreement for a rent certain. In other words, the rent must be a fixed amount or an amount capable of determination. It is not necessary that the rent be payable in money; it is sufficient if it is payable in anything upon which a definite value may be placed. To illustrate, the landlord may distrain for rent payable in improvements, services, or produce.[10]

Statutes have generally either abolished or greatly modified the right of distress. The seizure is usually required to be made by an officer because this procedure is less likely to result in a breach of the peace. The right is now ordinarily limited to a seizure of the property of the tenant; whereas under the common law the lessor was permitted to seize all property found on the premises. Modern statutes usually permit the lessor to sell the property of the tenant to satisfy his claim; whereas under the common law he had merely a retaining lien.

Recovery of Possession. At common law the landlord when entitled to possession may regain it without resorting to legal proceedings. This is known as the right of *re-entry.* The remedy is available in many states even when the employment of force is necessary. Other states deny the right to use force. One court says, "The right of re-entry, without judicial proceedings, is a qualified and limited one, and should be exercised with much caution, lest it occasion a breach of the

[9] *Evans* v. *Lincoln Co.*, 204 Pa. 448, 54 A. 321.
[10] *Brooks* v. *Cunningham*, 49 Miss. 108.

peace, in which case the lessor becomes a trespasser ab initio." [11] The landlord is liable for damages in case of a reentry made without right or in a wrongful manner.

> When possession was recovered unlawfully, the landlord was liable for any injury to the household goods of the lessee which he caused to be removed. (Johnson v. Nelson, 146 Wash. 500, 263 P. 949)

The landlord may resort to legal process to enforce his right to possession of the premises. For this purpose, various remedies are available. Some states allow a writ of entry, and others provide an action of trespass to try title. The action of ejectment, however, is ordinarily used. In addition to common-law remedies, statutes in many states provide a summary remedy to the landlord, which is much more efficient than the slow common-law remedies. Unless expressly stated, a statutory remedy does not replace those of the common law. Thus, "the summary remedy of forcible entry and detainer granted to a landlord is not exclusive, but cumulative to other remedies given him for the protection of his possession and of his rights as they exist at common law or under the statutes." [12]

QUESTIONS

1. A tenant's automobile was seriously damaged by the collapse of a small bridge on the leased premises. He brought an action for damages against the landlord. At the trial it was proved that the bridge had been defectively constructed and that this fact had been known to the landlord but not to the tenant. Was the latter entitled to recover damages?

2. Ream leased a building from Bradway for the purpose of conducting a retail grocery business. After taking possession, Ream erected a swinging sign over the entrance to his store. He later failed to repair the sign, and one day during a storm it fell and seriously injured Keggerreis who happened to be passing under it. Keggerreis brought an action for damages against Bradway. Was he entitled to judgment?

3. "Under the common law an assignment does not transfer the rights of the landlord as against the lessee unless the latter attorns to the assignee." What is meant by this statement?

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[11] *Bachinsky* v. *Fed. Coal, etc., Co.*, 78 W. Va. 721, 90 S. E. 227.
[12] *Chicago Gr. West. Ry. Co.* v. *Ill. Cent. Ry. Co.*, 142 Iowa 459, 119 N. W. 261.

4. Innys leased Scull's house and lot for a period of one year at a rental of twenty-four hundred dollars, payable in monthly installments on the last day of each month, the lease beginning on May 1. On July 1 Scull assigned the rent to Delavan. On July 31 Innys paid Scull the rent for two months, including the rent for June which had not been paid at the proper time. Delavan brought an action against Innys for the amount paid to Scull. Was he entitled to recover?

5. Klawans leases McLanes' farm for a period of ten years. During the sixth year Klawans notices that the farm is listed for sale during the month of September for three years' unpaid taxes. He thereupon pays the taxes in arrear in order to protect his interest. Is the tenant entitled to reimbursement from the landlord?

6. Benson leases Stookey's apartment house for a period of fifteen years. The agreement provides that Benson is to pay the taxes. Five years later the city constructs a storm sewer along the street near the apartment building, and an assessment for improvements is made against the property. Stookey calls upon Benson to pay this assessment. Benson contends that he is under no duty to do so. Do you agree?

7. Bogart leased Evans' farm for one year at a rental of seven hundred dollars. The agreement provided for a payment of two hundred dollars at the time of taking possession and a payment of the balance on September first. In August Bogart sold his crops to Levine. Evans contended that Levine took the crops subject to a lien for payment of five hundred dollars. Was his contention sound?

8. A statute in one state gives the landlord a lien on the personal property of the tenant for money due him for rent. Moore, who leased Rosene's farm and owed part of the rent, sells a span of horses and a harrow to Hunt. Rosene contends that Hunt takes the property subject to a lien in his favor for an advance which he made to Moore. Do you agree?

9. A tenant failed to pay the rent when due, and the landlord seized all of his personal property, including a tractor, to secure its payment. The next day a neighbor demanded the tractor which he had been permitting the tenant to use. The landlord refused to surrender it until the arrears were paid. Was the landlord entitled to hold the tractor?

10. "The right of distress when not abolished has been clearly modified by modern statutes." Explain this statement.

11. Machlis leases a given piece of land for a period of five years. At the termination of the lease he refuses to give possession of the premises to the landlord. How may the latter obtain possession of the land?

Part IV—Terminating the Relation

Expiration of Term. When a tenancy for years exists, the relation of landlord and tenant ceases upon the expiration of the agreed term. The date of termination may be and usually is set forth in the provisions of the lease. The exact date, however, may not be known, as the parties may agree that the term shall depend upon the happening of some contingency. Estates of which the terms are subject to conditions have been considered elsewhere.[1]

> When a lease is terminable only on certain conditions, such as when the lessor wants to improve or to occupy the premises, "the lessor cannot terminate the lease, except in pursuance of a bona fide intent to carry out the purpose referred to." (Southeastern Land Co. v. Clem, 239 Ky. 417, 39 S. W. [2d] 674)

At the expiration of the term fixed by the lease or at the happening of the agreed event, the tenancy ends without notice to quit on the part of the landlord, or notice of an intention to quit on the part of the tenant. In either case the terms of the agreement are sufficient notice to both parties of the expiration of the term. Express notice may be required of either or both parties by provisions in the lease to end the term, except when this would be contrary to a statute. For example, a requirement of notice is void when a statute declares that no notice to quit by the tenant is necessary to the termination of a tenancy the end of which is at a fixed or specified date.[2]

Release. At common law the relationship of landlord and tenant is terminated if the owner makes a conveyance of the reversion to the lessee by *release*. This type of conveyance was available under the common law when livery of seizin could not be made because the one to whom the conveyance was to be made was in possession.

A lease and a release were at one time useful methods of conveying land. By means of a lease the prospective purchaser

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[1] *Ante*, p. 735.

[2] *Levering Inv. Co.* v. *Lewis*, 200 Mo. A. 679, 208 S. W. 874.

or transferee took possession as a tenant. At a later date a release was made by the owner of the reversion to the tenant. The necessity of taking possession of the premises by the transferee was as vexing under this method of conveyance as in the case of livery of seizin, which has been previously discussed.[3] After the Statute of Uses, however, no entry was necessary. Under this statute the owner would make a bargain and sale for a year to the intended transferee, thus creating a use which the statute turned into a legal estate, without taking possession. Afterwards a release was given. This method of conveying land became very common at one time, because actual possession was not necessary.

Merger. If the tenant acquires the reversion by descent or by purchase, his estate and the buyer's estate are said to merge. It follows that if an estate descends to the tenant, as an heir of the lessor, the leasehold estate disappears as it merges into the estate of inheritance. The result is the same if the tenant has an estate for years and inherits a life estate in the same premises, irrespective of the number of years for which the lease is made, because a life estate is regarded as a greater interest than an estate for years. The reason for the termination is that it is impossible for the person to be both the tenant and the landlord in connection with the same piece of property.

Surrender. A surrender by the tenant of his estate to the lessor terminates the tenancy if the surrender is accepted by the latter. A surrender may be made expressly or impliedly. When implied by the conduct of the parties, it is said to be a surrender by operation of law.

> The acceptance by the tenant from the lessor of a new lease during the term of an existing lease "operates as a surrender of the first lease by operation of law." (Hallam v. Commerce Mining & Royalty Co., 49 F. [2d] 103)

An express surrender must, under the Statute of Frauds, be in writing and signed by the person making the surrender or by his authorized agent.[4] The agreement need not contain

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[3] *Ante*, p. 742.
[4] *29 Car. II*, ch. 3, §3.

any particular form of words. An agreement to surrender at a certain date or upon the happening of some contingency does not operate as a surrender, unless the estate is actually yielded up. To illustrate, it has been held that when the tenant refuses to carry out a promise to surrender, the landlord's only recourse is to sue for damages.[5]

A surrender by operation of law occurs only when the acts of the parties clearly show that both consider that the premises have been surrendered. It is "not to be implied against the intention of the parties as manifested by their acts and when such intention cannot be presumed without doing violence to common sense."[6] A surrender by operation of law occurs when the premises have been abandoned by the tenant and their return has been accepted by the landlord. An acceptance may be inferred from the conduct of the landlord, but such conduct must clearly show an intention to accept. The mere taking of possession and re-entry by the lessor does not per se prove an acceptance. He has the right to enter for the purpose of protecting or repairing the premises, and entrance for such purpose and the performance of such work will not convert a mere abandonment by the tenant into a surrender and an acceptance thereof. The same is true in the case of reletting. Whether an acceptance of a surrender is implied in such case depends on whether the landlord relets on his own or on the tenant's account.

Forfeiture. The lessor may terminate the tenancy by forfeiting the relation because of the tenant's misconduct or breach of a condition or covenant. The right of the landlord to terminate the relation for a breach of a covenant, however, does not exist in the absence of statute or of a forfeiture clause in the lease. This method of terminating the relation is not favored by courts, and the provisions of a lease providing for a forfeiture are construed strictly against the lessor.

> "Forfeiture clauses are not favored in either law or equity." (Baker v. Clifford-Mathew Co., 99 Fla. 1229, 128 S. 827)

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[5] *Fish* v. *Thompson*, 129 Mich. 313, 88 N. W. 896.
[6] *Coe* v. *Hobby*, 72 N. Y. 141.

Most leases provide that the lessor may forfeit the estate upon the tenant's breach of any or particular covenants. In the absence of such provision, however, forfeiture may be made when the tenant commits an act which amounts to a repudiation of the landlord's title. For example, if a tenant denies the title of the landlord and sets himself up as an adverse holder, the tenancy is forfeited.[7] Statutes in many states provide that the breach of certain covenants or the existence of certain conditions are grounds for forfeiture. To illustrate, some statutes provide for a forfeiture when the lessee refuses or neglects to pay the rent after a specified number of days' notice, or when the lessee uses the premises for specified purposes or for unlawful purposes in general.[8]

> A landlord, who made the statutory demand and therefore had a right to dispossess for nonpayment of rent, but who took no action to dispossess the tenant for over a year, waived his right. (Hoebel v. Raymond, 46 Ida. 55, 266 P. 433)

Statutes frequently prescribe the method of enforcement of a forfeiture. In the absence thereof the landlord must usually demand that the lessee remedy the cause or conditions upon which the forfeiture will be based as a condition precedent to declaring a forfeit. If the situation is not corrected, the landlord must then give notice of his intent to enforce a forfeiture. This rule is necessary because the landlord may waive the exercise of his right.

By Notice. A tenancy from year to year or month to month may be terminated at the end of the period by a notice to quit or a notice of intention to quit. In the absence of agreement or statute to the contrary, the landlord wishing to end the tenancy at the end of a period is required to give notice. The tenant is also usually required to give notice of his intention to quit. When either of them fails to give proper notice, the other party may elect to continue the relation for another period.

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[7] *Van Winkle* v. *Hinckle*, 21 Calif. 342.
[8] *McGarvey* v. *Puckett*, 27 Ohio St. 669.

A tenancy from year to year "is for a first period of time with an indefinite succession of periodic renewals unless determined by a notice to quit to the other by either the landlord or the tenant, since the right to a notice to quit is reciprocal." (Smith v. Pritchett, 168 Md. 347, 178 A. 113)

The requirement as to when notice must be given varies in the different jurisdictions. At common law six months' notice is necessary in case of a tenancy from year to year. When a tenancy is for periods less than a year, as from month

Toledo, Ohio, December 1, 19

Mr. George Knight:-

I hereby give you notice that I will quit and deliver possession, January 1, 19 , of the premises No. 208 Dover Road, in the city of Toledo, Ohio, which I now hold as tenant under you.

T S Olsen

NOTICE OF TENANT

NOTICE OF LANDLORD

To Mr. K. L. Jennings:-

You are hereby notified that there is now due me the sum of forty-five dollars, being rent for the premises situated in the city of Lexington in the state of Kentucky, and known and described as follows:

No. 1029 Main Street

And you are further notified that payment of said sum so due has been and is hereby demanded of you, and that unless payment thereof is made on or before the first day of July, 19 .., your lease of said premises will be terminated

Dated this 15th day of June 19 ..

Louis Stone
LANDLORD

NOTICE OF LANDLORD

to month, notice must be given the length of such period in advance. Some courts have held that a reasonable notice is sufficient. The length of time may, however, be fixed by agreement. The requirement of notice is now usually governed by statutes. Thus some statutes require only thirty days' notice to end a tenancy from year to year.[9] As to tenancies for periods of less than a year, the provisions of the statute may require only one week.[10]

No particular words are necessary to constitute notice, provided the words used clearly indicate the intention of the party giving it. The notice to quit or the notice of intention to quit must be definite. For example, when the tenant merely stated that he "guessed he would have to give up the house," it was held that there was insufficient notice.[11] Statutes sometimes require that the notice be in writing. In the absence of such a provision, however, oral notice is generally held to be sufficient.

QUESTIONS

1. Margolis leases Wills's farm for a period of ten years. At the end of this period Margolis moves from the premises without giving notice of his intention to quit. Wills contends that Margolis was under duty to give notice. Do you agree?

2. Bay leased a given piece of property from Meyer for a period of twenty-five years. Fifteen years later Meyer conveyed his reversionary interest to Bay. It was contended that this transaction terminated the relation of landlord and tenant between Bay and Meyer. Was the contention sound?

3. "A lease and a release were at one time useful methods of conveying land." What is meant by this statement?

4. Freidell leased an office building from his father, Rex Freidell, for ninety-nine years. Upon the father's death the son inherited a fee simple estate in the property. How, if at all, does this fact affect his leasehold estate?

5. Kearney leased a ranch to Miller. The agreement provided that Miller should dig an emergency well for use in case of a drought during the summer months. Miller refused to perform his promise at the request

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[9] *Tredick* v. *Birrer*, 109 Kans. 488, 200 P. 272.
[10] *Wilson* v. *Wood*, 84 Miss. 728, 36 S. 609.
[11] *Hunter* v. *Karcher*, 8 S. Dak. 554, 67 N. W. 621.

of Kearney, claiming that he held the property as absolute owner and could do as he pleased with it. Kearney thereupon contended that he was entitled to terminate the lease. Was Kearney's contention sound?

6. Weiper, who is tenant on Parkey's property, enters into an agreement in writing with the latter to surrender the leasehold estate on the first of the following month. At the agreed time Weiper refuses to yield up possession of the premises. Parkey brings an action to recover possession of the property from Weiper. Is he entitled to recover it?

7. Van Zandt has a leasehold estate in Ross's property for twelve years. Four years before the termination of the lease Van Zandt abandons the premises. Ross takes possession of the property, makes certain repairs, and relets the premises to Montgomery. When Ross sues Van Zandt for damages, the latter contends that the lease was surrendered. Is this contention sound?

8. Moffet leased a house and lot from Hagar. The agreement provided for certain improvements to be made by Moffet. Hagar later made a demand that Moffet carry out this covenant, but the latter refused. Hagar then sent notice to Moffet that he intended to terminate the lease. Moffet contended that Hagar had no right to end the lease on this ground. Do you agree?

9. Allen leased Minahan's farm from year to year. Six months before the end of one period, Minahan, while visiting Allen, stated, "I think that it may be necessary to require you to find another place for next year." At the end of the term Allen refused to move off the premises, contending that he was entitled to another term. Was his contention sound?

10. A lease executed by Bland and Skinner gave the former a tenancy from month to month. At the end of a given month Bland suddenly moved from the premises into an apartment house. Skinner brought an action against Bland to recover rent for the following month. Was he entitled to judgment?

CASES FOR REVIEW

1. John F. Edwards leased a farm to George W. Collins. The lease contained a covenant on the part of Collins that he would cultivate the land in the best possible manner. When this covenant was broken, Edwards brought an action to obtain possession of the land. In the absence of a statute or a forfeiture clause in the lease, was Edwards entitled to judgment? (Edwards v. Collins, 198 Mo. A. 569, 199 S. W. 580)

2. Emanual Isaac leased a store to Harris Cohen for a period of two years. Cohen caused a trade sign to be placed upon the wall of the building, just above the door. The sign consisted of a piece of iron moulded in the shape of a hat with the words "M. Cohen, Hatter," which was suspended by a wire from an iron bar extending from the building. The sign fell and struck Frank Di Marco who was passing along the sidewalk in front of the store. Di Marco brought an action against Isaac to recover damages. Was Di Marco entitled to judgment? (Di Marco v. Isaac, 74 Misc. Rep. 459, 132 N. Y. S. 363)

3. John H. Williams leased to John T. Mershon a farm in Monmouth County, New Jersey, for a period of one year, with an option of a further term of four years. During the year Mershon notified Williams that he would take the farm for one more year. Although notice to quit was not given to the tenant, Williams brought an action against Mershon to recover possession of the farm at the end of the first year. Was Williams entitled to judgment? (Williams v. Mershon, 57 N. J. L. 242, 30 A. 619)

4. George T. Stockholm owned certain real estate in the borough of Brooklyn, New York. For a consideration he gave to the Borough Bill Posting Company the exclusive privilege of erecting and using a sign-board to be located on the land for bill posting purposes. He reserved the right, in case the property was sold or required for building purposes, to cancel all privileges upon returning to the company a pro rata amount of the consideration. In an action brought by Stockholm against the company, it was contended that the foregoing transaction did not create the relation of landlord and tenant. Do you agree? (Stockholm v. Borough Bill Posting Co., 144 App. Div. 642, 129 N. Y. S. 745)

5. William H. Belote occupied a tract of land for several years as a tenant from year to year. The landlord, Lucius J. Kellam, within the time necessary for a notice to quit, proposed to Belote that the fixed rent of $350 be changed to a rental consisting of one third of the crops. Belote replied that he would do what is right. In an action brought by Kellam against Belote to recover possession of the land at the end of the year, Belote contended that he did not receive proper notice to quit. Do you agree? (Kellam v. Belote, 122 Va. 537, 95 S. E. 453)

6. Ann Francis Salisbury leased certain premises to William Shields, who covenanted to pay the taxes assessed against the property. Thereafter Shields assigned the lease to Shirley. The taxes for the last six months of the term were not paid; consequently the lessor was compelled to pay them. The lessor brought an action against Shirley to recover the amount of the taxes that she had paid. Was she entitled to judgment? (Salisbury v. Shirley, 66 Calif. 223, 5 P. 104)

7. Mrs. Willie L. Parker was the owner of a building that she leased to A. C. and L. E. Gortatowsky for use as a theater. The terms of

the lease stipulated an annual rental of $300. In an action brought by Mrs. Parker against the lessees to recover possession of the premises, a question arose as to when the rent was due in the absence of a statute or an agreement. What is your opinion? (Parker v. Gortatowsky, 129 Ga. 623, 59 S. E. 280)

8. A railroad company constructed a building near its station to serve as a boardinghouse and a lodginghouse. Thereafter it leased the premises to Darms. After several months Darms indicated his purpose of using the premises for gambling purposes. The carrier brought an action against Darms to restrain such action on the ground of improper use. Was it entitled to judgment? (New Orleans & C. R. Co. v. Darms, 39 La. Ann. 766, 2 S. 230)

9. Albert T. McGuinn leased certain premises to the B. H. Gladding Dry Goods Company, a corporation. Before the end of the term, the corporation abandoned the premises and without any letter or notice sent the door key to McGuinn, who kept it. In an action brought by McGuinn against the corporation for the rent, a question arose as to whether there had been a surrender of the lease. What is your opinion? (McGuinn v. B. H. Gladding Dry Goods Co., 40 R. I. 348, 101 A. 129)

10. J. N. and E. A. Jones occupied as tenants a farm belonging to W. R. Felker. A fence on the premises was injured as a result of rains. The tenants rebuilt and repaired the fence. In an action brought by Felker against the Joneses, it was contended that Felker was under an obligation to pay for the repairs. Do you agree with this contention? (Jones v. Felker, 72 Ark. 405, 80 S. W. 1088)

11. John Willis held certain land under a tenancy that terminated at the end of the calendar year. Without permission of the landlord, J. W. Harrel, he held over after December 31 of the foregoing calendar year. Harrell brought an action shortly after the end of the year to dispossess Willis. What tenancy, if any, did Willis have after December 31? (Willis v. Harrell, 118 Ga. 906, 45 S. E. 794)

12. On the twenty-ninth day of April, C. F. Eisely leased to George Weigle certain real estate for a term of one year. The rent reserved was two fifths of the wheat, rye, oats, and corn raised on the premises during the year. About a month later Eisely made a general conveyance of the land to A. M. Spooner and Thomas W. Lyman. The share of the crop reserved as rent was delivered by Weigle to the grantees, Spooner and Lyman. Thereafter Eisely brought an action against the grantees to recover the value of the rent collected by them. Was he entitled to judgment? (Eisely v. Spooner, 23 Nebr. 470, 36 N. W. 659)

13. R. M. Morse and others leased to M. L. Chapman an office in a building in Denver, Colorado, known as the "Boston Building." The furniture owned and used by Chapman was mortgaged to W. F. Morrison to secure the payment of a note. Chapman became indebted to the lessors for the sum of $250, the rental of the office for ten months.

During subsequent litigation between Morrison and the lessors, it was contended that in the absence of a statute or an agreement the lessors did not have a lien on the property of the tenant. Do you agree? (Morse v. Morrison, 16 Colo. A. 449, 66 P. 169)

14. Alice A. Beverly executed to Edward Keenan a lease of certain premises in Providence, Rhode Island, for a term of ten years. About six months later Keenan's license to carry on his business expired, and he was unable to obtain another license. For this reason he contended that he had been evicted and refused to pay the rent. Henry F. Miller, executor of the estate of the lessor, brought an action against John J. Maguire, who guaranteed the payment of the rent, to recover the amount of rent due. Was he entitled to judgment? (Miller v. Maguire, 18 R. I. 770, 30 A. 966)

15. Maria Addis leased certain real estate in the city of Grand Rapids, Michigan, to the Walter K. Schmidt Company. The lease provided that the lessee should not assign or transfer the lease, or sublet the premises, without the written consent of the lessor. It also provided that upon breach of the provision, the lessor might re-enter and repossess the premises. The lessee later transferred all its property, including the lease, to the Huber Drug Company. Sophie A. White and another, who took the rights of the lessor who died, brought an action to recover possession of the premises. Were they entitled to judgment? (White v. Huber Drug Co., 190 Mich. 212, 157 N. W. 60)

16. Jennie E. Cornelius leased to John E. McLain a farm on Blackbird Creek in the state of Delaware. Thereafter she had an officer, Harry S. Willey, seize certain personal property of the tenant under a distress warrant. She asserted a claim against McLain for breach of a contract to deliver certain pelts of muskrats, for failure to pay the rent, consisting of one half of the grain and the fruit raised on the farm, and for failure to cultivate and manage the farm in a good and proper manner. Was the lessor entitled to exercise the right of distress as security for these claims? (McLain v. Willey, 30 Del. 598, 110 A. 560)

CHAPTER XVI

TORTS

Part I—General Considerations

Introduction. Modern business produces controversies of more or less seriousness. These arise out of the fact that in our economic organization great emphasis is placed upon individual activities. If unlimited action were accorded the individual, it would be impossible to maintain smooth and orderly social and economic processes which are essential to even a semblance of the vast and complicated economic machine of today. As a consequence, society has effected a compromise in prescribing the rules of the game. The law gives each individual such freedom of activity as is compatible with the rights granted to others. When one goes beyond the restrictions imposed by society upon individual conduct, the acts become wrongful. If a wrongful act results in an injury to another, the law requires that redress be made in the form of compensation for such injuries. Under these circumstances, the law of torts has an important place in the study of business.

The law of torts is of ancient origin. Early common law recognized that every individual possessed certain fundamental rights, and it sought to enforce retribution from the person who violated such rights. In a sense, however, the law of torts is not old, but comparatively new. With the passing years new conditions brought the development of wrongful acts which were previously unknown. Again, different circumstances render it advisable to declare acts which were once lawful to be unlawful. Under circumstances not essentially different from those of the past, an act, once lawful, may be declared wrongful, because of a changing and perhaps more enlightened conception of justice. Hence it may be found that the legal principles governing a particular wrong or tort are of comparatively recent origin.

The man in business should be particularly interested in this portion of the law which embodies rules, standards, and principles concerning situations from which he can scarcely

escape. He is confronted daily with situations involving legal consequences, and he should recognize their dangers. He is concerned with the results which the law attaches to his acts not only in relation to the persons with whom he deals, but to all the world, and to the acts of persons in their conduct toward him and his business. In general, the infringement of rights to which the law affords protection centers around wrongs against the security of person, of property, of business relations, and of business transactions.

Definition. The term *tort* refers to a private injury or wrong arising from a breach of a duty created by law. It is often defined as "a wrong independent of contract." [1] Writers generally agree that it is difficult, if not impossible, to give a clear, concise definition of tort.[2] For this reason, other wrongs will be briefly considered and distinguished.

Moral Wrongs. Most torts, although not all, involve moral wrongs, but not all moral wrongs are torts. There can be no infringement of a legal right by the violation of a moral duty until the latter is made a legal duty. "If I know that a villain intends to defraud or in any way injure my neighbor, it is doubtless my duty as a good citizen and as a Christian man to put him on his guard. But there is no rule of law which renders me liable for his loss in case of neglect of the duty. It is a moral duty simply, not recognized by law." [3]

Breach of Contract. The wrongs or injuries caused by a breach of contract arise from the violation of an obligation or duty created by consent of the parties. A tort arises from the violation of an obligation or duty created by law. It should be noted, however, that in some instances the same act may be both a breach of contract and a tort. To illustrate, when an agent exchanges property instead of selling it as directed by the principal, he is liable for breach of contract or for tort.[4]

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[1] *Denning* v. *Tate*, 123 Calif. 316, 55 P. 1000.
[2] Restatement of the Law of Torts (hereafter cited as R.), Secs. 1, 3, and 4.
[3] *Ohio & M. R. Co.* v. *Kasson*, 37 N. Y. 218.
[4] *Haas* v. *Damon*, 9 Iowa 589.

Crimes. A crime is a wrong arising from a violation of a public duty,[5] whereas a tort is a wrong arising from a violation of a private duty. Not all torts are crimes, and not all crimes are torts, but an act may be both a crime and a tort. For example, when one negligently breaks a window in another's store, the act constitutes a tort; but if one did it willfully and wantonly, the act would also constitute the crime of malicious mischief.[6] On the other hand, carrying concealed weapons may be a crime, but it is not a tort.

Wrongdoers. In general, all persons are responsible for their torts or wrongful acts. In a few instances, where a public officer acts for the state, there is no liability either on the part of the officer or the state. The latter cannot be sued by an individual except with its consent. In other instances the law may limit the tort liability of certain classes. An infant (any person not of legal age) is not liable for torts based upon a breach of contract. Thus, when an infant negligently fails to care for bailed property, in accordance with his agreement, he cannot be sued in tort, as this would in effect be holding the infant to his contract.[7] An insane person is liable as a general rule only for compensatory damages, and the tendency has been to exempt such persons from torts involving malice.

> Complete immunity from liability in tort is possessed by "no one, except the State." (Restatement, Torts, Sec. 887)

Joint Wrongdoers. In many instances a tort may be caused by several wrongdoers. It is important to determine whether they are joint wrongdoers, for in such case each is liable for the entire injury, regardless of the extent of his contribution. A joint wrong exists when there is concert of action or agreement between the parties, although the injury is done by one. A joint wrong is also committed where the parties act independently but produce a single injury. For example, in one case "each of the defendants was guilty of negligence in not having sufficient wall to sustain his building. By reason

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[5] *Post*, p. 911.
[6] *Loomis* v. *Edgerton*, 19 Wen. (N. Y.) 419.
[7] *Slayton* v. *Barry*, 175 Mass. 513, 56 N. E. 574.

thereof, both buildings fell upon and destroyed plaintiff's building. They did not fall at different times, nor on different parts of plaintiff's building as appears from the declarations, but fell together in one mass, undistinguishably upon, and crushed the same, so that it was impossible to say which produced the greater ruin, or to separate the extent of damage by each. But both contributing thereto, both are liable for the whole damage done, and cannot complain because they are both brought before the court in the same suit." [8]

> Except in cases of independent acts contributing to a nuisance, "each of two or more persons whose tortious conduct is a legal cause of harm to another is liable to the other for the entire harm." (Restatement, Torts, Sec. 875)

Contribution. Joint wrongdoers are liable jointly and severally. In other words, the injured party may sue each, all, or any of them. When he has recovered judgment against each separately, he may elect to satisfy the largest. If one joint wrongdoer is compelled to pay, he cannot ordinarily enforce contribution of indemnity against the others. There are, however, two general exceptions to this rule. One includes cases in which the plaintiff is technically liable, but as between the parties he was no wrongdoer. To illustrate, when an agent innocently commits a tort at the direction of the principal, he may recover indemnity.[9] The other exception includes cases in which both are wrongdoers, but in which "the offense is merely *malum prohibitum*, and is in no respect immoral." For example, when two creditors in good faith wrongfully attach certain goods and one is required to pay damages, the latter may recover contribution from the other.[10]

Voluntary Act. The first essential of legal culpability in the law of torts is that the defendant must be guilty of a voluntary act or omission.[11] There is no reason for shifting the burden of an injury to one who has caused it by an involuntary act or omission. In this connection, acts which are committed or omitted by one who is confronted with sud-

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[8] *Johnson* v. *Chapman*, 43 W. Va. 639, 28 S. E. 744.
[9] *Bailey* v. *Bressing*, 28 Conn. 455.
[10] *Vandiver* v. *Pollak*, 97 Ala. 467, 12 S. 473.
[11] R., Sec. 2.

den peril or pressing danger are considered as having been committed or omitted involuntarily. For example, where one, in order to escape danger, kicks aside an ignited firecracker or bomb, or throws a burning lamp in such a way that another is injured, there is no liability. "This rule seems to be founded upon the maxim that self-preservation is the first law of nature and that, where it is a question of whether one of two men shall suffer, each is justified in doing the best he can for himself." [12]

In general, the intent of the defendant to do wrong is immaterial. It is no defense that the act was innocently done and entirely without design to commit a tort. To illustrate, when one, under a mistake as to the limits of his farm, crosses the boundary line and enters the premises of his neighbor, he is guilty of trespass, although acting in good faith.[13] Motive is likewise immaterial as a general rule. In most instances any legal right may be exercised even with bad motives, and an act which is unlawful is not made legal by good motives.

Proximate Cause. It has been noted that one is in general liable only for his voluntary acts. In order to fix responsibility upon one as a wrongdoer in the eyes of the law, it is also necessary to show that the injury was the proximate result of the voluntary act.[14] It is not deemed socially desirable, and is doubtless impracticable, to attempt to hold one responsible for all the injuries which flow indirectly from his misconduct. The question whether an injury is proximately caused by an act is frequently a perplexing problem. This is true because of the difficulty in applying the rules to a given set of facts. Whether an act is the proximate cause of an injury is usually a question of fact for the jury to determine.

There are various tests by which the jury is instructed to determine whether or not an act is the proximate cause. One test is to discover whether there was an unbroken sequence of events. This consists of determining "whether the

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[12] *Laidlow* v. *Sage*, 158 N. Y. 73, 52 N. E. 679.
[13] *Perry* v. *Jeffries*, 61 S. C. 292, 39 S. E. 515.
[14] R., Sec. 9.

facts constitute a continuous succession of events so linked together that they become a natural whole, or whether the chain of events is so broken that they become independent and the final result cannot be said to be the natural and probable consequence of the primary cause" [15] Another test involves the foreseeability of the consequences of the act. In such a case "it is not essential that the negligence should be the direct cause of the injury. It suffices that it is the natural and probable cause. It is the natural cause when either it acts directly in producing the injury, or sets in motion other causes so producing it and forming a continuous chain in natural sequence down to the injury; thus linking the negligence with the injury by a chain of natural and consequential causation, although the former may be neither the immediate nor the direct cause of the event. But such causation cannot be proximate cause in law to arouse liability, unless an ordinarily prudent and intelligent person ought, in the exercise of such intelligence, to have foreseen that an injury might probably result from the negligence under like circumstances." [16]

> In case of a conspiracy to injure a party's reputation, in which one means employed was to induce such party to commit a crime and to obtain proof by use of a dictograph, the arrest of the party "is a natural consequence that must be anticipated." (Mangum Electric Co. v. Border, 101 Okla. 64, 222 P. 1002)

It is generally held that if there is an intervention of natural force, the sequence of events is treated as continuous.[17] For example, when one is negligent in burning dry grass on his premises and sparks are carried by the wind to his neighbor's premises, the chain of events is unbroken.[18] The same is true when there is the intervention of an involuntary act of another. On the other hand, it is held that the intervention of a voluntary act or the omission to perform a duty by another breaks the sequence. To illustrate, when there is

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[15] *Quinlan* v. *Philadelphia*, 205 Pa. St. 309.
[16] *Meyer* v. *Milwaukee Elect. R. R. Co.*, 116 Wis. 336, 93 N. W. 6.
[17] R., Sec. 279-(c).
[18] *Poeppers* v. *Mo. K. & T. R. R. Co.*, 67 Mo. 715.

a pit in the highway due to the negligence of the defendant, and a third person throws another into the pit, the defendant is not liable, as the sequence of events is not continuous.[19] An exception to this rule is made, however, when such an intervention is reasonably foreseeable.

QUESTIONS

1. Babington contends that the government should not in any way restrict actions of individuals engaged in economic activities. Do you agree?

2. A beggar who is standing near the entrance of a suburban train station solicits alms from Cressey. The latter refuses his request and hurriedly walks past him. Has Cressey committed a tort?

3. Drake suddenly becomes ill and summons the aid of Worth, a physician. The latter dislikes Drake very much because of a business deal in which they were involved many years before. When Worth answers the summons for aid, he intentionally administers poison to Drake. Is Worth guilty of a tort, a crime, or a breach of contract?

4. An infant purchases a given quantity of palm leaves from Paulet. After disposing of the leaves to another and squandering the proceeds, the infant rescinds the agreement. Paulet brings an action for damages alleging that the infant under these circumstances is guilty of a tort in that he sold the property. Is Paulet entitled to recover?

5. Cornwall, an infant, rented a radio. One evening he became displeased with the program which was being broadcast and kicked the instrument from its stand. The dealer sued Cornwall for damages. Is the latter liable for the injury to the property?

6. Tilbury brings an action for damages against Channel, an insane person. He alleges that the latter maliciously spread false reports about him. May Tilbury recover damages?

7. Because of the failure to keep the stairway of a public building in a safe condition, Black is injured. He brings an action for damages against the state. Is Black entitled to recover for his injuries?

8. Atkins, in accordance with an agreement with Grange, engages the attention of Clancey so that the latter may be injured by Grange. May Clancey sue them jointly or individually? What is the extent of the liability of each party?

9. Gaunt and Chritholm by agreement and concerted action defraud Maloney of $5,000. The latter brings an action against Chrit-

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[19] *Alexander* v. *Town of New Castle*, 115 Ind. 51, 17 N. E. 200.

holm and recovers full damages. Chritholm sues Gaunt for one half the amount he was compelled to pay Maloney. Is he entitled to recover this amount?

10. Greenwich and Klinck are engaged in the grocery business as partners. Hinman, who is employed by them to make deliveries, negligently drives the delivery truck into Newberry's automobile. Newberry recovers from Klinck damages for the injuries sustained. May the latter compel Greenwich to assume all or any portion of the loss?

11. Gresham, while delivering some packages to Thynne, left his truck with the engine running before the door of the latter's store. A small boy who happened to be passing played with the clutch until the machine was set in motion. The unguided truck ran into Haddon's store front. Haddon brought an action for damages against Gresham. Was he entitled to recover?

12. An ignited bomb was thrown into the home of Roscoe Terry who tossed it through a window into the street. The explosion of the bomb injured Hoeger who happened to be passing at that time. Hoeger sued Terry for damages. Was the latter liable for the injuries suffered by the former?

13. Treneon injured another's automobile under an erroneous impression that the machine belonged to him. When sued, he offered evidence to show that there was no design on his part to injure the plaintiff's automobile. If proved, would that fact affect his liability?

14. Carroll negligently builds a fire beneath some electric wires. The result is a short circuit which causes a fly wheel to injure Burghley. Burghley brings an action for damages against Carroll. Is the latter liable for the injury to Burghley?

15. Greene negligently throws a small box from a window. It is carried by the wind in such a manner as to cause an injury to Frisby. The latter brings an action for damages against Greene. Is he entitled to recover for the injury received?

Part II—Security of Person

Assault. Everyone has a right to engage in business pursuits or social activities without being placed in fear of personal insecurity. "One of the most important objects to be attained by the enactment of laws and the institutions of civilized society is that each of us shall feel secure against unlawful assaults. Without such security, society loses most of its value. Peace and order and domestic happiness, inexpressibly more precious than mere forms of government, cannot be enjoyed without the sense of perfect security. We have a right to live in society without being put in fear of personal harm." [1]

> The interest protected is freedom from apprehension of offensive as well as harmful contact. (Restatement, Torts, Topic 3)

An *assault* may be defined as an offer of force causing reasonable fear of an apparent intent to inflict physical injury, coupled with an apparent present ability to carry it into execution.[2] Mere words are insufficient; there must be some display of force. "In order to constitute an assault there must be something more than a mere menace. There must be violence begun to be executed. But where there is a clear intent to commit violence accompanied by acts which if not interrupted will be followed by personal injury, the violence is commenced and the assault is complete." [3] It is also necessary that there be an apparent intent to inflict injury. The defendant may allay by his words any fear which would ordinarily accompany his acts of a threatening nature. For example, when he seizes his sword, stating, "If it were not assize time, I would not take such language," there is no assault.[4] Another element of the offense is that there must exist apparent present ability to carry out the threat. Hence a threat with a gun by one who is clearly beyond shooting distance is insufficient. It is not the actual ability that is im-

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[1] *Beach* v. *Hancock*, 27 N. H. 223.
[2] R., Sec. 21.
[3] *People* v. *Yalas*, 27 Calif. 630.

portant, but whether one reasonably believes present ability exists. Thus one may be guilty of assault by threatening with an unloaded gun another who believes it is loaded.[5]

Battery. Everyone is entitled to live in society free from unlawful physical impacts. The basis of this right is as strong as, if not stronger than, in the case of assault. When an assault is carried into execution, the result is what is known as a *battery.* A battery has been defined as "an unlawful touching of the person of another by the aggressor himself or any other substance put in motion by him." [6]

Most batteries are in the form of physical attack, but violence is not necessary. It is not the force of the impact which constitutes the wrong, but the way in which it is done.[7] To illustrate, there are many instances throughout the day when one gently touches another while passing through a crowd, and there is no wrong; but if such an act were done in a rude and insolent manner, there would be.[8] Violence is important only in determining the amount of damages.

> A battery may consist of an offensive as well as a harmful contact. (Restatement, Torts, Sec. 18)

If there is a force directed against objects which at the time are closely associated with the person, it is not necessary that the aggressor actually touch the person of another. For example, there may be a battery by striking a fence or rail against which one is leaning.[9] Nor is it necessary that the aggressor personally touch the person or associated objects. It is sufficient if there is an impact by some agency which he sets in motion. To illustrate, to throw mortar unlawfully on the person of another is a battery.[10]

An assault and battery is excused when done under some circumstances. It is justified, as a general rule, when necessary to recover property in fresh pursuit of a wrongful taker. It also is justified in defense of oneself, of a member of the

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[5] *State* v. *Godfrey,* 17 Oreg. 300, 20 P. 625.
[6] *Kirkland* v. *State,* 43 Ind. 146.
[7] R., Secs. 13 and 18.
[8] *Cole* v. *Turner,* 6 Mod. 149.
[9] *Kendall* v. *Drake,* 67 N. H. 592, 30 A. 524.
[10] *Peterson* v. *Haffner,* 59 Ind. 130.

family, of one under another's protection, and of property. In defending the person or property, as in removing a trespasser, one is entitled to use only such force as is necessary to accomplish the purpose. When excessive force is employed, the first defender then becomes the aggressor and a wrongdoer.

Invasion of Privacy. The *right to be let alone* will be discussed here, although some courts treat it as a property right. It frequently happens that the name or picture of a person may be peculiarly adaptable for beneficial advertising or trade purposes. A question arises whether either may be used without the consent of that person. A few courts hold affirmatively, apparently on the grounds of convenience. Thus, it is stated that "the so-called right of privacy is, as the phrase suggests, founded upon the claim that a man has the right to pass through this world, if he wills, without having his picture published, his business enterprises discussed, his successful experiments written up for the benefits of others, or his eccentricities commented upon either in hand bills, circulars, catalogues, periodicals, or newspapers, and necessarily that the things which may not be written and published of him must not be spoken of him by his neighbors, whether the comment be favorable or otherwise. If such principle be incorporated into the body of the law through the instrumentality of a court of equity, the attempts to logically apply the principle will necessarily result not only in a vast amount of litigation, but in litigation bordering upon the absurd, for the right of privacy, once established as a legal doctrine, cannot be confined to the restraint of the publication of a likeness, but must necessarily embrace as well the publication of a word picture, a comment upon one's looks, conduct, domestic relations, or habits." [11]

> The interest in freedom from unreasonable interference with privacy includes interest in not having one's affairs known, as well as not having one's likeness exhibited to the public. (Restatement, Torts, Sec. 867)

A majority of the few decisions on this point, however, take the contrary view. One court, in a long opinion show-

[11] *Roberson* v. *Rochester Folding Box Co.*, 171 N. Y. 538, 64 N. E. 442.

ing careful consideration of the question, adopts as its own a dissenting opinion in the case just cited, and states: "Instantaneous photography is a modern invention and affords the means of securing a portraiture of an individual's face and form *in invitum* their owner. While, so far forth as it merely does that, although a species of aggression, I concede it to be an irremediable and irrepressible feature of social evolution. But if it is to be permitted that the portraiture may be put to commercial or other uses for gain by the publication of print therefrom, then an act of invasion of the individual's privacy results, possibly more formidable and painful in its consequences than an actual bodily assault might be. Security of person is as necessary as the security of property, and for that complete personal security which will result in the peaceful and wholesome enjoyment of one's privileges as a member of the society, there should be afforded protection, not only against scandalous portraiture and display of one's features and person, but against the display and use thereof for another's commercial purposes or gain." [12]

False Imprisonment. Everyone is entitled to be free from unlawful detention of the person. When one unlawfully detains another, he commits a wrong or tort known as *false imprisonment.*[13] Although this wrong is based upon a violation of personal liberty, it is closely associated with assault and battery, for in many instances it is accomplished by means of force or intimidating threats. Coercion, but not actual force, is necessary to constitute an imprisonment. Hence an imprisonment exists when one submits to an arrest by another under legal authority or pretended legal authority.

> Physical restraint is unnecessary to establish false imprisonment when there is "a reasonable belief that resistance or physical attempts to escape the room or store would have been useless and futile." (Halliburton-Abbott Co. v. Hodge, 172 Okla. 175, 44 P. [2d] 122)

In order that there be imprisonment, one must also be conscious of the restraint. To illustrate, if one locks the only

[12] *Goodell* v. *Tower*, 77 Vt. 61, 58 A. 790.
[13] R., Sec. 35.

exit to a room in which another is sleeping and unlocks it before the sleeper awakens, there is no imprisonment.[14] Moreover, there must be a total restraint. When all points of exit are closed but one, there is mere interference with one's freedom; when one's progress is blocked but it is possible to return or go by another route, there is no imprisonment. "A prison may have its boundary large or narrow, visible and tangible, or, though real, still in the conception only; it may itself be movable or fixed; but a boundary it must have, and that boundary the party imprisoned must be prevented from passing; he must be prevented from leaving within the ambit of which the party imprisoning would confine him, except by prison breach." [15] The final element of this wrong is that the imprisonment must be unlawful.

> "Mere loss of freedom alone cannot constitute imprisonment," as, for example, when one is lawfully ejected as a trespasser upon his neighbor's land, "his freedom is interfered with, but he is not imprisoned." (Dillon v. Sears-Roebuck Co., 125 Nebr. 269, 249 N. W. 604)

When one is unlawfully imprisoned, he has, in addition to a right of damages, the right to obtain his discharge by means of a *writ of habeas corpus*. This writ is issued by a competent court addressed to the custodian of a person, directing that he produce the person before the court and show cause why the prisoner should be restrained. In case the restraint proves to be unjustified and unlawful, the court will cause the prisoner to be discharged.

Malicious Prosecution. Everyone has the right to be free from undue molestation in the courts. One violating this right commits a wrong or tort for which the law gives the injured party a remedy in the form of an action for damages known as *malicious prosecution*. Damages may be recovered not only for resulting loss of time and money, but also for injury to feelings and reputation.[16] In respect to the latter, this tort involves the security of business relations, as it is in a sense

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[14] *Herring* v. *Boyle*, 1 Cromp. M. & R. 377.
[15] *Bird* v. *Jones*, 7 Q. B. 742.
[16] R., Secs. 670, 671, and 681.

an aggravated form of libel. In many states, however, there is no remedy given for civil proceedings which do not involve an arrest of the person, or in which there is no actual or technical arrest or seizure of property. A few states deny the right for criminal actions when no actual or technical arrest or imprisonment has been made.

> The giving to a warden of the United States information concerning night shooting in violation of a Federal statute cannot constitute the basis of an action for malicious prosecution. (Petherbridge v. Bell, 146 Va. 822, 132 S. E. 683)

One cannot complain of either a criminal or civil proceeding brought against him merely because it proves unfounded. This tort involves a compromise between the rights of the members of society. Although one member has a right to be free from prosecution for crimes of which he is innocent, and from defending false civil claims, public policy requires that this right be modified by the rights of other members of society. The latter have a right to seek redress in the courts for claims honestly believed to be existing, and to protect society from crime by honest prosecution of supposed wrongful acts, without risk of liability for damages if mistaken. As a result, one is entitled to complain when he is damaged by action brought against him only when two elements are present. First, there must be a want of probable cause.[17] By this is meant that there must be an absence of circumstances which would cause a reasonably prudent man to believe that they constitute grounds for the action brought. "The question does not depend upon the actual state of facts in the case, but upon the honest and reasonable belief of the prosecutor that there is a reasonable ground of suspicion, supported by circumstances sufficient to warrant an ordinarily prudent man in believing the accused party is guilty of the offense." [18] The second essential element is malice which, in this connection, refers to motives.[19] "The books agree that the prosecution need not have been prompted by malevolence or any corrupt design, nor necessarily involve hatred toward the person accused. It is

[17] R., Secs. 653-(a)-(1) and 674-(a)-(1).
[18] *Coyle* v. *Snellenberg*, 30 Pa. Sup. 246.
[19] R., Secs. 653-(a)-(2) and 674-(a)-(2).

enough if it be the result of any improper or sinister motive and in disregard of the rights of others." [20] In some instances malice may be inferred from the fact that there is a want of probable cause.

If either of the elements mentioned above is missing, the injured party has no remedy. When one complains of an action brought by another, it is usually a good defense to show that it was brought in good faith upon the advice of counsel before whom all the facts known were laid.[21] There is no ground for complaint when the actions are brought on just claims, even though prompted by malice.[22]

QUESTIONS

1. Abbot, holding a large club in his hands, says to Barker, "If it were not Sunday, I would flatten your head." Barker sues Abbot for an assault. Is he entitled to recover?

2. Armstrong stated to Porter by telephone that he was prepared to horsewhip him when they met. Porter brings action against Armstrong for assault. Is the latter liable?

3. Burton threatens to shoot Norris and at the same time points an unloaded revolver at him. Norris knows that the weapon is unloaded. Is Burton guilty of assault?

4. Sidney is seated immediately behind Campe on a train. Becoming bored with the long trip, he starts to amuse himself and other passengers by brushing a feather across Campe's neck. Is Sidney guilty of any wrong against Campe?

5. Bateman, while riding a horse for exercise, stops to argue with Collins about a local election. Their argument becomes heated, and Collins in anger strikes the horse which Bateman is riding. Is Collins guilty of a battery?

6. Hilliard is in the act of striking a younger brother of Trenton when he is knocked down by Trenton. Hilliard sues Trenton for damages. Is the latter liable for a battery?

7. Bonner slaps Morgan with his open palm. The latter draws a jackknife and severely wounds Bonner. Bonner sues Morgan for damages. Is Morgan guilty of assault and battery?

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[20] *Jenkins* v. *Gilligan*, 131 Iowa 176, 108 N. W. 237.
[21] R., Secs. 666 and 675-(b).
[22] R.. Sec. 657.

8. Erickson complains to Jacobs of a severe physical attack made upon him by Curran. Jacobs tells him that the extent of the violence employed by Curran does not in any way affect the latter's liability. Do you agree?

9. A manufacturing corporation uses Strickler's photograph on the containers of the products which it sells. Strickler sues the company for damages. Is he entitled to recover?

10. Smithers personifies an officer and makes an unjustifiable arrest of Courtney. Courtney brings an action against Smithers for false imprisonment. Is he entitled to recover damages?

11. Unknown to Southgate, at ten o'clock Stokes locks the door of the room in which the former is working and unlocks it an hour later. If there was no other exit, does Stokes's act constitute imprisonment?

12. Sully is unlawfully arrested and detained in the county jail. A visitor tells him that his only remedy is an action for damages. Do you agree?

13. For the purpose of harassing Blackburn, Logan brings an action against him. Blackburn sues Logan for malicious prosecution. Logan proves at the trial that he had reasonable grounds for the action. Is Logan's defense valid?

14. Cecil caused Shaftesbury to be arrested and tried for theft. The latter was proved innocent of the charge. He now brings an action for malicious prosecution against Cecil. The latter's defense is that he acted on the advice of counsel. Is Shaftesbury entitled to recover damages?

Part III—Security of Property

Trespass. The peace and order of society require protection of the possession of the rights in property given to the individual. Hence any infringement upon the right of possession of another is a tort known as *trespass* for which damages may be recovered in an *action of trespass.*[1] The first element of the offense is that the plaintiff must have a right to possession. For example, where the owner rents his house to one person and his automobile to another, in each case for a period of one year, only the tenant or the bailee may claim trespass in the event of an injury to the property during that period.[2] This does not mean, however, that the owner is without a remedy, for he may be able to maintain an action of *trespass on the case* which is used to recover damages for indirect injuries to property or person.[3] The second element is that there must be a wrongful and forcible interference with the possession.

> " 'Any abuse of, or damage done to, the personal property of another, unlawfully, is a trespass, for which damages may be recovered.' Civil Code, Sec. 4485." (Vaughn v. Glenn, 44 Ga. A. 426, 161 S. E. 672)

In respect to real property, any unauthorized entry thereon or injury to the property constitutes a trespass.[4] One may also be guilty of the offense when there is an entry by agencies which he sets in motion. For example, if one by means of a log boom causes water to flood another's land, he is guilty of trespass.[5] The same is true when animals are driven upon the land, or when stones are cast thereon by a blast or other means. In respect to personal property, any act which interferes with another's possession is a trespass. To illustrate, when one moves another's vehicle without authority from one side of the street to the other, the act is technically a trespass.[6]

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[1] R., Sec. 218.
[2] *Lunt* v. *Brown*, 13 Me. 236.
[3] R., Sec. 220-(a).
[4] R., Secs. 158 and 164.
[5] *Hueston* v. *Miss., etc., Boom Co.*, 76 Minn. 251, 79 N. W. 92.
[6] *Bruch* v. *Carter*, 32 N. J. L. 554.

Every trespass gives the one whose possession is disturbed a right to recover damages to the extent of the injury. In case of no loss, nominal damages only may be recovered. When the injury is caused in a particularly wanton and malicious spirit, exemplary or punitive damages may be recovered. *Smart money*, as exemplary or punitive damages are sometimes called, is an amount over and above the actual injury which is allowed to the plaintiff as a punishment to the wrongdoer and as a deterrent to others. If the injured party has been deprived of his personal property, he may also recover it in an action of *replevin*. If he has been ousted of his possession of real property, he may recover the same in an action of *ejectment*.

Conversion. The right to regain possession of personal property withheld wrongfully is not adequate protection in all cases. One might not desire the property in its condition upon being returned; or in some instances it might be impossible to return property which had been destroyed. Fortunately, an action of *trover* has developed to enable the person entitled to possession of property to recover the value thereof from the one guilty of converting it.[7]

> Holding that trover would not lie for interference with a laundry route, the court said that trover would lie for unlawful interference "with personal property specific enough to be identified, but not with such indefinite, intangible, and uncertain property rights as the mere good will of a business or trade secrets." (Olschewski v. Hudson, 87 Calif. A. 242, 262 P. 43)

The first element necessary to maintain an action of trover is that the plaintiff must have possession or the right to immediate possession. One is, however, not required to be the owner. For example, anyone, such as a bailee or a thief, having the right to possession against all but the true owner, may maintain an action of trover.[8] The second element is that the goods must have been converted by the defendant. The essence of conversion is the wrongful exercising of dominion over property inconsistent with another's right of possession.

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[7] R., Sec. 222.

[8] *Aschermann* v. *Philip Best Brewing Co.*, 45 Wis. 262.

Conversion may occur in one of three ways: namely, "(1) by wrongfully taking a personal chattel; (2) by some illegal assumption of ownership, or by illegally using or misusing goods; or (3) by a wrongful detention." [9]

It is not necessary that there be a physical possession of the property, so long as there is a wrongful exertion of the dominion over it. Wrongful intent is immaterial. For example, one who purchases goods from a thief, although in good faith and for value, is a converter.[10] If the goods are lawfully in another's possession, conversion occurs upon a demand and a wrongful refusal to return. Demand and refusal are only evidence of, and do not necessarily amount to a conversion, because one may be justified in refusing to return the goods (as in case of a lien), or because it may be impossible for a bailee to return the goods, which have been destroyed or stolen through no fault of his own.

Nuisance. The right of one to use his property is limited to some extent by the rights of others to enjoy their property. Hence one must use and enjoy his property in such manner as will allow others to do the same with their property. "In the enjoyment of his own land, one must be confined to such reasonable use thereof as will not inflict injury upon his neighbor, or interfere with his neighbor's reasonable enjoyment, and must submit to such inconveniences as necessarily result from the reasonable use and enjoyment by his neighbor of land belonging to him." [11] This quotation gives one a general idea of the offense known as *nuisance* which is difficult to define. In general, however, it is any unlawful omission or act in respect to personal conduct or the use of property which interferes with the rights of others.[12] For example, loud and boisterous singing in one's house throughout the night would interfere with the right of the adjoining property owners to rest; hence it would constitute a nuisance.[13]

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[9] *Anderson* v. *Gouldberg*, 51 Minn. 294, 53 N. W. 636.
[10] *Hyde* v. *Noble*, 13 N. H. 494.
[11] *Butterfield* v. *Klaber*, 52 How. (N. Y.) 255.
[12] R., Sec. 201-(d).
[13] *Medford* v. *Levy*, 31 W. Va. 649, 8 S. E. 302.

A cleaning and dyeing business, if operated so as to emit fumes and gases which affect the health or comfort of surrounding property owners, will constitute a nuisance. (Cleaners & Dyers v. Allbrecht, 157 Md. 389, 146 A. 233)

Nuisances may be classed as *per se* and *in esse*. A nuisance per se is one which is inherently unlawful, as property used for immoral purposes. A nuisance in esse is one which becomes unlawful because of the circumstances. To illustrate, otherwise lawful businesses, such as maintaining a stockyard, may become unlawful when located in a residential district.[14]

An airport "is not a nuisance per se, although it might become such from the manner of its construction or operation." (Thrasher v. City of Atlanta, 178 Ga. 514, 173 S. E. 817)

Nuisances may again be classed as public and private. A nuisance is public when it infringes upon a common right. It is private when it infringes on the rights of certain members of society. The same condition may constitute both a private and a public nuisance.[15] For example, an obstruction of a street is a public nuisance, but it may also be private in that it injures the business of a storekeeper on that street.[16]

In case of a private nuisance, the injured party has three remedies. He may abate the nuisance himself, if it can be done without breach of the peace; he may sue for damages at law; or he may seek an abatement by injunction, as well as damages in the court of equity.

Negligence. One is entitled to be free from injuries to his property, as well as his person, which are caused by the failure on the part of another to exercise a proper degree of care. The party who violates his legal duty to exercise the care required by circumstances and causes another to suffer damages is guilty of a tort known as *negligence*. The elements of this tort are, first, a duty on the part of the defendant to exercise care in respect to the plaintiff; second, a failure to perform that duty; and, third, a resulting injury to the plaintiff.[17]

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[14] *Bielman* v. *Chicago, St. P. & K. C. Ry. Co.*, 50 Mo. A. 151.
[15] R., Sec 201-(c).
[16] *Platt & Speith* v. *C. B. & Q. Ry. Co.*, 74 Iowa 127, 37 N. W. 107.
[17] See R., Sec. 281.

Duty of Care. In general everyone owes a duty to conduct himself so as to cause no injury to his fellowmen. In some cases this is an absolute duty to all. For example, in most states the keeper of a known dangerous or vicious animal is liable for any injuries caused by it, irrespective of his attempts to restrain it.[18] On the other hand, one may owe a duty to some, but not to others. To illustrate, courts in the past have taken the view that the maker or vendor of an article owes no duty to persons other than the immediate vendee, except when such articles consist of food, drugs, and the like, which are dangerous to the health and life of the community.[19] The tendency of modern decisions, however, is to eliminate the distinction in this connection between the immediate and remote vendee. A duty to some persons but not to others also exists in the case of the landowner. He owes a duty of care in keeping his premises safe for invitees, and of warning a licensee of dangers which he knows will be encountered; but he owes no duty to a trespasser, except that he cannot willfully make the premises unsafe for the purpose of injuring him.

> The general rule as to trespassers applies also to children, but in many states, under the doctrine of "attractive nuisance," courts "do not regard a child of tender years, attracted by something on the premises which appeals to his curiosity, as a trespasser." (Drew v. Lett, 95 Ind. A. 89, 182 N. E. 547)

Degree of Care. The care required of a person is that of an ordinarily prudent man under similar circumstances. If one is engaged in services requiring skill, the care must, of course, assume greater diligence. In all cases it is the diligence, attention, and skill which can reasonably be expected. Whether one has exercised such care is a question to be determined by the jury. The plaintiff must ordinarily show a failure to exercise reasonable care. In some cases, however, negligence is presumed. The doctrine of *res ipsa loquitur*, "the thing speaks for itself," is that a prima facie case of negligence is made upon a showing that an injury was caused by an inanimate object within the control of the defendant. The

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[18] *Hayes* v. *Miller*, 150 Ala. 621, 43 S. 818.
[19] *Huset* v. *J. I. Case Threshing Machine Co.*, 120 F. 865.

doctrine is applied only when common experience has proved that injury is not caused by such objects or apparatus except in the absence of due care. To illustrate, negligence is presumed upon a showing that one is injured by a window falling from its proper place.[20]

> The rule of res ipsa loquitur "is at best an evidential inference not binding upon a jury, but to be considered by it under proper instructions." (St. Marys Gas Co. v. Brodbeck, 114 Ohio St. 423, 151 N. E. 323)

Contributory Negligence. At common law one cannot recover for injuries due to another's negligence, if his own negligence has contributed to the injury. The plaintiff's negligence, however, must be a proximate cause in order to defeat recovery. In this connection there has developed the doctrine of *last clear chance*. This rule declares that although the plaintiff is negligent, the defendant is liable if he had the last clear chance to avoid the injury. In such a case the theory is that the plaintiff's negligence is not the proximate cause and therefore does not contribute to the injury. Thus, when the plaintiff negligently fetters an animal on a public road and the defendant negligently runs into it, the latter is liable.[21]

Waste. The person entitled to the possession of real property may be guilty of wrongful acts or omissions which injure the rights of the one entitled to the reversion or the remainder.[22] The latter cannot claim that such conduct amounts to a trespass, as this tort is an injury to possession. A remedy was given at common law, however, under the rule that one who is in possession of an estate and is guilty of some act or omission which destroys or lessens the value of the inheritance, commits a wrong or tort known as *waste*. This wrong may take one of two forms or both. Voluntary waste consists of an affirmative act, such as removing fixtures. Permissive waste is the failure to exercise proper care in preventing injury to the premises, as when the buildings are injured because of lack of ordinary repair.

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[20] *Carroll* v. *C. B. & N. Ry. Co.*, 99 Wis. 399, 75 N. W. 176.
[21] *Fuller* v. *Ill. Cent. Ry. Co.*, 100 Miss. 705, 56 S. 783.
[22] See R., Sec. 186.

The cutting of trees, not for the sake of clearing the land, but for sale, was held to be waste, for which there could be a recovery for "such amount as the fair market value of the property had been reduced by the removal of the timber." (Campeau v. Hobbs, 259 Mich. 93, 242 N. W. 850)

Whether an act or omission constitutes waste is a question of fact for the jury and is frequently difficult to determine. An act may be wrongful in one community or under some circumstances, and not wrongful in other localities or under different circumstances. Positive acts are generally measured by the standard of good husbandry in that community. In respect to permissive waste, the tenant is under a duty no greater than to make such ordinary repairs as will prevent decay of the premises. "If a window in a building should blow in, the tenant could not permit it to remain out and the storm to beat in and greatly injure the premises, without liability for permissive waste; and if a shingle or board on the roof should blow off, or become out of repair, the tenant could not permit the water, in time of rain, to flood the premises and thus injure them, without a similar liability. He being present, a slight effort and expense on his part could save a great loss; and hence the law justly casts the burden upon him." [28]

QUESTIONS

1. Brooks rents a canoe from Colton for one year. Six months later, Dennis cuts a hole in one side of the canoe. Is Colton entitled to bring an action of trespass against Dennis?

2. Leighton collects all of the stones and cans on his property and tosses them upon the land belonging to Sheldon. The latter brings an action of trespass against Leighton. Is Sheldon entitled to bring this action?

3. A doctor parks his car in front of a patient's home and leaves it unlocked. Later he discovers it has been taken by Bothwell who claims it as his own. Is Bothwell liable for trespass? Does the doctor have any remedy other than a suit for damages?

4. Lauderdale had a grudge against a pharmacist in his neighborhood. One day when there were many patrons in the pharmacy, he deliberately threw a stone through the plate glass front of the pharmacy, causing a loss of $400. Was the pharmacist entitled to damages for an amount over and above this sum?

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[28] *Suydam* v. *Jackson*, 54 N. Y. 450.

5. Claverhouse purchased a farm in another state. Later he decided to live on the property. Thinking it to be his farm which he had not seen, he innocently took possession of property belonging to Monmouth. What remedy did Monmouth have?

6. Minter drives his automobile across Nordick's lawn. Nordick brings an action of trespass against Minter. The latter claims that no cause of action exists because no loss can be shown. Is his contention correct?

7. Lister takes Engle's typewriter without the latter's knowledge. Clayton takes and withholds the machine from Lister. Lister brings an action for conversion against Clayton. Is Clayton liable to Lister?

8. Ten sacks of flour were stolen by Tyrconnel from Clarendon's warehouse. Tyrconnel stored the flour with Germain. Twelve days later Germain returned the flour to Tyrconnel upon his demand. When Clarendon learned of the transaction between Tyrconnel and Germain, he brought an action for conversion against the latter. Was Germain liable to Clarendon for the value of the goods?

9. Finch steals a basket of pears which he sells to Hamilton. The latter has no knowledge of the theft and purchases the fruit in good faith. The owner brings an action for conversion against Hamilton. Is the latter liable to the owner?

10. Hobbes borrows an adding machine from Armstead. Several weeks elapse and the machine is not returned to Armstead. The latter is advised by another that if he demands the machine and Hobbes fails to return it, there is a conversion for which he has a right of action. Has Armstead been correctly advised?

11. Schultz constructs a plant for the manufacturing of fertilizer in the center of a residential district. Is this a nuisance per se or a nuisance in esse? Explain the difference.

12. Ackerman drives to the city for the purpose of making several purchases. While there he parks his car so as to prevent traffic from passing on a certain street. Does this constitute a public or a private nuisance?

13. Waller accumulates a pile of trash in his backyard. Some boys add a couple of dead cats to the pile. Filmer, who lives next door, complains of the odor emanating from the trash, but Waller disregards his complaint. What are Filmer's remedies, if any?

14. Verney, while strolling in the park, observed Overton swimming in the lagoon. Overton suddenly became exhausted and called for help. Verney did not go to his assistance; and when a life guard finally rescued Overton, he was nearly drowned. Overton sued Verney for negligence. Was he entitled to recover damages?

15. Morley, while walking in Baxter's garden, was seriously injured by a small bridge giving way under him. Is Baxter liable for injuries suffered by Morley?

16. Eller, when starting home from work, slipped upon the icy pavement and fell. It was discovered that a bone in his arm was broken. He was taken back to his place of employment where Doermann attempted to set the broken bone. What degree of care was required of Doermann?

17. Kemper is injured by a radio set falling from Farar's window. The latter defends an action brought against him for damages by claiming that Kemper has not shown that he failed to exercise reasonable care. Is this a valid defense?

18. Artman, reading a book while walking across a busy street, is injured by a bullet from a gun which Burton negligently fired in that direction. Burton disclaims responsibility on the ground of contributory negligence. Is his contention sound?

19. Mason leases Curtis' farm for one year. During this period he fells several fruit trees and removes all of the fences. Curtis claims that Mason is guilty of trespass. Is he correct?

20. Fieldman gives Carter permission to hunt upon his land. He fails to inform Carter of the fact that certain fences, which he knows Carter will climb over, are charged with electricity. Does Fieldman fail to perform a duty owed to Carter?

21. Bricker habitually cut across the property of Terry whenever he was late for the bus that took him to his work. Therefore Terry constructed a contrivance which would dump a box filled with bricks upon Bricker while passing under a certain tree. Was Terry legally justified in so doing?

22. A flower pot fell from a window of the apartment occupied by Fuller. The receptable and contents landed upon a lady who was passing on the street below, causing serious injury to her. It was contended that there was a presumption of negligence on the part of Fuller. Do you agree?

Part IV—Security of Business Relations

Wrongful Interference. One of the primary rights of an individual is to earn his living by selling his labor or by engaging in trade or business. Any wrongful interference with this phase of one's liberty is a tort for which damages may be recovered or which, in some cases, may be restrained by an injunction. The policy of the law is to make the market substantially free to all. "It is freedom in the market, freedom in the purchase and sale of all things, including both goods and labor, that our modern law is endeavoring to insure to every dealer on either side of the market. The valuable thing to merchant and to customer, to employer and to employee, manifestly, is freedom on both sides of the market." [1]

The right to conduct one's business, however, is subject to equal rights on the part of others. Hence the injuries suffered by one in business through legitimate competition give no right of redress.[2] A business may be destroyed by another, so long as he engages in lawful competition. The law is concerned with wrongful interference, endeavoring to furnish protection against illegal means, such as intimidation, obstructions, and molestation. It has been considered a wrongful interference if one destroys the business of another for a malicious purpose, although legal means are used.[3] For example, if a wealthy banker opens a barber shop solely for the purpose of injuring the business of another barber shop, "he is guilty of a wanton wrong and an actionable tort." [4]

Inducing Breach of Contract. Another form of interference with business relations is the wrongful procuring of a breach of a contract. "Our law recognizes a contract right as property which is to be protected against undue interference by persons not parties to the contract. When a third party intentionally, by the use of any kind of means, causes a breach of the contract involving damage, he is *prima facie* guilty of a tort." [5]

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[1] *Jersey City Printing Co.* v. *Cassidy, et al.*, 63 N. J. Ed. 759, 53 A. 230.
[2] R., Sec. 708.
[3] R., Sec. 709.
[4] *Tuttle* v. *Buck*, 107 Minn. 145, 119 N. W. 946.
[5] *Boot* v. *Burgess*, 72 N. J. Eq. 181, 65 A. 226.

When the breach is procured by unlawful means, a right to damages is conceded by all courts. In respect to contracts of employment, a few courts deny a recovery when they are not for a specified period, or, in other words, when they are at will. Some courts deny recovery when the breach of contract, other than of a contract of employment, is induced by persuasion only. Courts differ in respect to recovery for procuring the breach of a contract which is legally unenforceable, as a contract which is not in writing as required by statute.

> One court, in denying the defendant's contention that there was no liability because the contract was not in writing, declared: "It does not rest with him to say that the parties thereto will not abide by the same regardless of the statute." (Ringler v. Ruby, 117 Oreg. 455, 244 P. 509)

It seems that a desirable social policy would be to hold one liable when he knowingly and without justification procures the breach of any contract by any means. It further appears that such acts should be considered as justifiable in rare cases only. Certainly competition should not be an excuse. There are doubtlessly instances in which the relation of the parties or the fact that unprejudiced advice was solicited should excuse the act. Thus one court states that "a father who discovered that a child of his had entered into an engagement to marry a person of immoral character, would not only be justified in interfering to prevent that contract from being carried into effect, but would greatly fail in his duty to his child if he did not." [6]

Combination to Divert Trade. Business relations may be disturbed by a combination to keep third persons from dealing with another who is the object of attack. Such a combination, resulting in jury, constitutes an actionable wrong known as *conspiracy* if the object is unlawful, or if the object is lawful but procured by unlawful means.

If the object of the combination is to further the interests of the association, no actionable wrong exists so long as lawful means are employed. For example, when employees are

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[6] *Legris* v. *Marcotte*, 129 Ill. A. 67.

united in a strike, they may peacefully persuade others to withhold their patronage from the employer.[7] On the other hand, all combinations to drive or keep away customers by violence, force, threats, or intimidation are actionable wrongs. To illustrate, a combination is usually treated as an unlawful conspiracy for which damages may be recovered, when the customers are threatened or subjected to strikes, and for this reason withdraw their patronage.[8] The means used by this form of combination constitute a threatened or actual secondary boycott which is also usually treated as an actionable wrong against the customers. To what extent these long-established rules or their applications have been changed, with respect to unions and striking employees, by recent decisions of the Supreme Court, is not as yet clear or settled.

Slander. Everyone is entitled to security of reputation. This is a right of greatest importance in respect to business relations. "A man of affairs, a businessman, who has been seen and known by his fellowmen in the active pursuits of life for many years and who has developed a good character and an unblemished reputation, has secured a possession more useful and more valuable than lands, or houses, or silver, or gold. Taxation may confiscate his lands; fire may burn his houses; thieves may steal his money; but his good name, his fair reputation, ought to go with him to the end—a ready shield against the attacks of his enemies, and a powerful aid in the competition and strife of daily life." [9] Reputation is injured by defamation which is a publication tending to cause one to lose the esteem of the community.[10] One form of actionable defamation is *slander*. It exists when the publication is by spoken words or transitory gestures.[11] The mere utterance of words defaming another, however, is not necessarily actionable.[12]

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[7] *Parkinson* v. *Building Trades Council*, 154 Calif. 581, 98 P. 1027.
[8] *Gray* v. *Building Trades Council*, 91 Minn. 171, 97 N. W. 663.
[9] *Times Publishing Co.* v. *Carlisle*, 94 F. 761.
[10] R., Sec. 559.
[11] R., Sec. 568-(2).
[12] Malice, often named as a necessary essential, is purposely omitted because it is unnecessary and usually causes confusion. As used here, it means so-called legal malice, which merely means without privilege.

A defamatory insinuation is as actionable as a positive statement, "when the meaning is clear." (Duncan v. Record Pub. Co., 145 S. C. 196, 143 S. E. 31)

Publication. There must be a publication of the defamatory matter.[13] By publication is meant the conveyance of the idea or thought to a third person. To illustrate, if the words cannot be heard, understood, or comprehended by a third person, there is no publication.[14]

"It is not a publication to speak the slanderous words only in the presence and hearing of the persons slandered." (Bull v. Collins [Tex. Civ. A.], 54 S. W. [2d] 870)

Damages. There must be an allegation and proof of damages, except when the words are actionable per se. In the latter case, damages are presumed for the purpose of maintaining an action, at least; because from common experience it is known that damages occur as a natural consequence to the publication of charges of a serious nature. Words that are actionable in themselves (per se) fall into three general classes.[15] The first class includes words which charge another with the commission of a crime involving moral turpitude and infamous punishment. For example, damages are presumed when one charges another with having committed murder or larceny.[16] The second class includes words which impute a disease at the present time which will exclude one from society. To illustrate, the charge of having leprosy or social diseases is actionable per se.[17] The third class includes words which have a tendency to injure one in his business, profession, or occupation. Thus any words "which impute to merchants, traders, or other businessmen, insolvency, financial difficulty, or embarrassment, dishonesty, or fraud, or which in any other manner are prejudicial to them in the way of their employment or trade, are actionable per se." [18]

Statements by a milk dealer that his competitor sells dirty, fifthy, and unhealthful milk were actionable per se. (Kendall v. Lively, 94 Colo. 483, 31 P. [2d] 343)

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[13] R., Sec. 577.
[14] *Micling* v. *Quasdorf*, 68 Iowa 726, 28 N. W. 41.
[15] R., Sec. 570.
[16] *Krebs* v. *Oliver*, 12 Gray (Mass.) 239.
[17] *Williams* v. *Holdredge*, 22 Barb. (N. Y.) 396.
[18] *Fred* v. *Taylor*, 115 Ky. 94, 72 S. W. 768.

Falsity. The charge must be false. There is no liability for making true statements.[19] If, however, the defendant uses as his defense that a statement is true but does not succeed in proving that it is true, the damages will be increased as such a plea is treated as a repetition and thus an aggravation of the offense.

Privilege. Under certain circumstances it is deemed socially desirable that there be no liability even when false defamation is published and causes damages. These instances fall into two groups. One gives absolute privilege and is confined to public officers who in the performance of their duty should have no fear of possible liability for damages.[20] This class, for example, includes legislators, judges, and attorneys when making statements in connection with their duties.[21] The other group of circumstances affords a conditional privilege.[22] "A communication made bona fide upon any subject matter in which the party communicating has an interest, or in reference to which he has a duty, is privileged if made to a person having a corresponding interest or duty, although it contain criminatory matter which, without this privilege, would be slanderous and actionable." [23] This is illustrated when a person, in protecting his interest, charges another with having stolen a watch or other property.[24]

> Communications of a naval officer are absolutely privileged, "provided they are, first, authorized by law; second, made in the course of duty; and third, the statements complained of are germane to the subject-matter involved in the communications." (Miles v. McGrath, 4 F. Supp. 603)

It should be noted that it is the circumstances which make the privilege and not the statement. If one goes beyond that which is reasonably necessary to protect the interest, there is no reason to give immunity. Hence, when one makes a statement that is irrelevant, or gives to a relevant statement

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[19] R., Sec. 582.
[20] R., Secs. 585 to 592.
[21] *Munster* v. *Lamb*, 11 Q. B. 588.
[22] R., Secs. 593 to 598.
[23] *Harrison* v. *Bush*, El. & Bl. 344.
[24] *Klinck* v. *Colby*, 46 N. Y. 427.

unnecessary publicity, he is liable.[25] The same is true when the party's action is prompted by bad motives. The privilege of the circumstances in the second group is conditional upon the absence of actual malice or ill will.[26]

Libel. Another wrong against the security of business relations takes the form of written defamation. This is known as *libel.* Although usually in writing, it may be in print, picture, or in any other nontransitory form affecting the eye.[27] For example, to construct the means of execution for crime in front of another's residence is libelous in form.[28]

> Defamation published by radio broadcasting constitutes libel when "the speaker reads from a prepared manuscript or speaks from written or printed notes or memoranda." Under some circumstances an extemporaneous broadcast will constitute libel instead of slander. (Restatement, Torts, Sec. 568, Comm. f)

The elements necessary to maintain an action for libel are the same as for slander with one exception.[29] In case of libel it is not necessary, as a general rule, to allege and prove damages, as such will be presumed.[30] In other words, all forms of libel are generally considered as actionable per se. This is an old and established rule, although the basis of the exception is sometimes questioned. In referring to this exception, one court states: "It is curious that they have also adverted to the question, whether it tends to produce a breach of the peace; but that is wholly irrelevant, and is no ground for recovering damages. So it has been argued that writing shows more deliberate malignity; but the same answer suffices, that the action is not maintainable upon the ground of malignity, but for the damages sustained. So it is argued that written scandal is more generally diffused than words spoken, and is therefore actionable; but an assertion made in a public place, as upon the Royal Exchange, concerning a merchant in London, may

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[25] R., Sec. 604.
[26] R., Sec. 603.
[27] R., Sec. 568-(1).
[28] *Monson* v. *Tussauds*, 1 Q. B. 671.
[29] At common law truth is no defense to a criminal action for libel.
[30] R., Sec. 569.

be much more extensively diffused than a few printed pages dispersed, or a private letter; it is true that a newspaper may be very generally read, but that is all casual. These are the arguments which prevail on my mind to repudiate the distinction between written and spoken scandals. . . . If the matter were for the first time to be decided at this day, I should have no hesitation in saying that no action could be maintained for written scandal which could not be maintained for the words if they had been spoken." [31]

QUESTIONS

1. It is said that the policy of the law is to make the market free to all. What does this mean? Is it in your judgment a sound policy?

2. Hogan has engaged in the grocery business in a given community for over a period of twenty years. Grant opens another grocery store in the same neighborhood and diverts two thirds of Hogan's trade. The latter goes into bankruptcy and sues Grant for damages. Is Hogan entitled to recover?

3. Snowden and Bartlett are competitors in the selling of jewelry. Bartlett threatens Snowden's customers, thus causing them to cease trading with the latter. Snowden sues Bartlett for damages. What is the latter's liability, if any?

4. Reardon, a wealthy real estate broker, opens and operates a first-class pharmacy near Cartwright's pharmacy. His purpose is merely to drive Cartwright out of business. Is Reardon guilty of an actionable wrong?

5. Dorsey is employed under contract for one year. He leaves the employment at the end of six months, because of threats made by Cunningham. The employer sues Cunningham for damages. Is he entitled to recover from the latter?

6. Cooper, who is ignorant of the fact that Darwin is bound by contract to work for another, offers the latter a large salary to work for him. Darwin accepts the offer. His former employer now sues Cooper for damages. Is the latter liable to the employer?

7. Mattox sues Brandon for inducing breach of contract. The latter pleads competition as an excuse. Is this a valid defense?

8. Jenks believes that McKechnie has taken some money from his cash drawer. He immediately calls an officer who happens to be across

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[31] *Thorley* v. *Lord Kerry*, 4 Taunt. 355.

the street at the time. When the officer has approached within two feet of Jenks, the latter shouts the charge of theft against McKechnie so that it can be heard by persons standing seventy yards away from the officer. It turns out that McKechnie is not guilty of the charge. In an action for damages brought by McKechnie against Jenks, the latter alleges privileged communication as a defense. Is the defense valid?

9. The employees of Gage are on a strike to gain higher wages and by agreement peacefully persuade many customers to cease trading with their former employer. Does this combination constitute an actionable wrong?

10. Buckingham hangs Raleigh in effigy in a public place. Hillman defames Forhan by whistling a certain song as the latter passes. Do these acts constitute slander or libel?

11. Butler is a member of the city council. For the purpose of compelling Butler to vote for reduction of taxes, his employees walk out on a strike and by agreement peacefully persuade Butler's customers to trade elsewhere. Does the action of the employees constitute an actionable wrong?

12. Tristam calls Wriggler a thief in the presence of Pricer. Does this constitute a publication of defamation? Explain.

13. Stubbs tells Rashall that Wakeman, a physician and surgeon, "is nothing more than a butcher." Wakeman brings an action for slander against Stubbs without alleging damages suffered. Is Wakeman entitled to judgment?

14. During the course of a trial the judge states that Bateson is giving false testimony. Bateson, who is a minister, brings an action for slander against the judge. The latter pleads privileged communication as a defense. Bateson offers evidence to show that the defendant made the statement because of ill will toward him. Is the evidence admissible?

15. Harrison, who cannot find his watch, reports to an officer that Daugherty had stolen it. The charge proves to be false. Is Harrison liable to Daugherty?

16. Stephens states in a letter addressed to Prothero that Seeley is a bankrupt. He also makes the same statement about Creighton in a speech being broadcast by radio. Seeley and Creighton are laborers. Is the defamation in either case actionable per se?

Part V—Security of Business Transactions

Deceit. An individual is entitled to fair and honest treatment in a business transaction. He is not entitled, generally speaking, to the benefit of another's knowledge. He may not complain of undisclosed facts, unless there is a duty to disclose such matters.[1] On the other hand, when material facts are disclosed, he is entitled to expect them to be true. Hence one who fraudulently misrepresents a material fact for the purpose of inducing another to rely thereon is liable to the other for the resulting harm.

Statement of Fact. The misrepresentation must ordinarily relate to a present or a past fact. A representation of the law, when it is a statement of the legal consequences of certain facts, is fundamentally an opinion. There is no liability for a statement of opinion, belief, or judgment, unless the speaker does not have such opinion, belief, or judgment, in which case he misrepresents a fact, that is, his state of mind.[2] This is also true of a statement of intention.[3]

Fraudulent Misrepresentation. The misrepresentation is fraudulent when the speaker knows or believes the matter to be other than he has represented it to be. The same is true when the speaker has no belief in the truth of his statement, when he makes the statement recklessly, irrespective of its truth or falsity, and when he has no basis for the knowledge or belief that he asserts.[4]

Intent to Influence Action. The maker of a fraudulent misrepresentation must intend that the person or persons to whom it is made should act thereon. There may be an intent to influence the conduct of another although the statement is not made directly to such a person. This occurs when a statement is made to one person for the purpose of having him repeat its terms to another, or when a statement is made in a financial report for the purpose of inducing the public to act thereon.[5]

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[1] R., Sec. 551.
[2] R., Sec. 525.
[3] R., Sec. 530.
[4] R., Sec. 526.
[5] R., Secs. 531, 532, 533, and 534.

Reliance. The recipient of a fraudulent misrepresentation must justifiably rely thereon. He is not required, however, to investigate the truth of the statement. He is justified in relying upon its truth, although he might have ascertained the falsity of the statement had he attempted to do so.[6]

Causation. The loss of the recipient of the fraudulent misrepresentation must be the result of his justifiable reliance upon the misrepresentation. The loss must be caused by the belief in the truth of the misrepresentation, and not as the result of an independent investigation by the recipient of the statement. The Restatement expressly declares also that the maker of a fraudulent misrepresentation is not liable to one who does not rely upon his statement but who acts upon the expectation that the maker will be held liable for damages as the result of the false statement.[7]

Disparagement of Goods and Slander of Title. In the transaction of business one is entitled to be free from interference by means of malicious false claims or statements in respect to the quality or the title of his property.[8] To illustrate, one is negotiating a sale of an automobile to another. The latter is informed by a third party, who is trying to harass the vendor, that the machine is a very old one. As a consequence the buyer refuses to purchase the machine. The vendor is entitled to an action against the third party for damages.[9] In order to establish a wrong for disparagement of property, however, the plaintiff must establish certain facts.

> The disparagement of the quality of land, chattels, and intangible things is sometimes called "trade libel." (Restatement, Torts, Ch. 28, Topic 2)

Falsity. The charge must be proved false. If it is true, there is no liability for the injuries caused by the statement.[10] Unlike the cases of libel and slander, there is no rule providing a presumption of falsity.

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[6] R., Secs. 537 and 540.
[7] R., Secs. 546, 547, and 548.
[8] R., Secs. 624 and 626.
[9] *Wilson* v. *Dubois*, 35 Minn. 471; 29 N. W. 68.
[10] R., Sec. 634.

Malice. Courts also state that the charge must be maliciously made. By this is meant that the charge must be made without justification.[11] One is not liable even though the statement is false when he makes it in good faith to protect what is believed to be his rights. "It is clearly not actionable for a man to assert his own rights at any time; and even where the defendant fails to prove such right, still, if at the time he spoke he honestly supposed such right to exist, no action lies." [12]

Damages. Special damages must be alleged and proved. In other words, the plaintiff must prove that damages proximately resulted from the charge which is set forth in the declaration.[13] This will necessarily include proof of a publication of the charge to a third person. Publication of disparaging matter is its communication intentionally or by negligent act to some person other than the one whose interest is disparaged.[14]

Infringement of Trade-Marks. One has a right not to be disturbed or defrauded in the transaction of business by another who seeks to exploit his goodwill.[15] This wrong may take the form of infringement of a trade-mark.[16] By this is meant the unauthorized use of an exact or similar copy of a mark previously appropriated for that class of goods.

> " 'The common law of trademarks is but a part of the broader law of unfair competition.' " (Sweet Sixteen Co. v. Sweet "16" Shop, 15 F. [2d] 920)

A *trade-mark* is a name, device, or symbol appropriated to distinguish the goods of one person from similar goods of another. It belongs to the person by whom it is first adopted and used, by affixing it to goods placed upon the market. Geographical and descriptive names cannot ordinarily be adopted

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[11] R., Secs. 625 and 628.
[12] *Hopkins* v. *Browne*, 21 R. I. 20.
[13] R., Sec. 633.
[14] R., Sec. 630.
[15] The rules governing trade-marks are in general applicable to trade names. R., Sec. 711-(b).
[16] R., Sec. 711-(b).

as trade-marks. To illustrate, "liquid glue" is not a proper trade-mark.[17] Such names may, however, be used when they do not denote origin, style, or quality. "There are strong reasons and high authority for the contention that a geographical name, when not used in a geographical sense, that is, when it does not denote the location of origin, but is used in a fictitious sense merely to indicate ownership and origin independent of location, may be a good trade-mark. For example, 'Liverpool' for cloth made at Riedersfield." [18]

> "Terms merely descriptive of quality cannot be appropriated as trademarks." (Van Camp Sea Food Co. v. Westgate Sea Products Co., 28 F. [2d] 957)

In case of infringement, the owner of the mark may sue for damages and may enjoin its further use.[19] The basis of this right is sometimes placed on the grounds of fraud upon the public, or of an infringement of a property right in the mark. Perhaps the best reason assigned is that it interferes with the owner's business rights by robbing him of his goodwill. It is not necessary that the copy be identical. "If the form, marks, contents, words, or other special arrangement or general appearance of the words of the alleged infringer's device, are such as would be likely to mislead persons in the ordinary course of purchasing the goods, and to induce them to suppose that they were purchasing the genuine article, then the similitude is such as entitles the injured party to equitable protection, if he takes seasonable measures to assert his rights and prevent their continued invasion." [20]

Unfair Competition. There are methods other than the infringement of a trade-mark or a trade name by which one may palm off his goods to the public under the guise of another's goods.[21] These practices are frowned upon by the courts and are subject to an injunction on the grounds of

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[17] *Russia Cement Co.* v. *Le Page*, 147 Mass. 206, 17 N. E. 304.
[18] *Drake Medicine Co.* v. *Glesner*, 68 Ohio St. 337, 67 N. E. 722.
[19] R., Secs. 744 and 745.
[20] *Ball* v. *Siegel*, 116 Ill. 137, 4 N. E. 667.
[21] R., Sec. 711-(a) and (c).

unfair competition.[22] One guilty of such practices for the purpose of obtaining the benefit of the reputation of another is liable for any loss to the other party.[23]

> "The essence of the wrong in unfair competition consists in the sale of goods of one manufacturer or vendor for those of another." (Tipps Fireworks Co. v. Victory Sparkler & Specialty Co., 57 F. [2d] 864)

Under the preceding topic it was noted that certain terms could not be used as trade-marks or trade names. When one has adopted such terms, however, he may under some circumstances restrain another from using them. "Words or symbols naturally descriptive of the product, while not adapted for exclusive use as a trade-mark, may yet acquire, by long and general usage in connection with the preparation and by association with the name of the manufacturer, a secondary meaning or signification, such as will express or betoken the goods of that manufacturer only; and in this sense he will be entitled to protection from an unfair use of the designation or trade-name by others that may result in his injury and in fraud of the public." [24]

Another form of unfair competition whereby one is able to fraudulently dispose of his wares is the imitation of signs, store fronts, advertisements, and dress of goods.[25] Thus, when one adopts a box of distinctive size, shape, and color in which to market candy, and another appropriates the same style, form, and dress of the package, the latter may be enjoined from its use, and may in some cases be liable for damages.[26] "It is wholly immaterial, where this right has been invaded, that the retail or wholesale dealer, who may be the immediate purchaser of goods put out in imitation, is not misled as to their identity. The wrong of unfair competition is present where goods are so dressed in form, or marked by decorative symbols, that the ultimate consumer either is or possibly may be deceived, or that the infringer intended to deceive the public. He is bound to know the probable conse-

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[22] R., Sec. 744.
[23] R., Sec. 745.
[24] *Standard Varnish Works* v. *Fisher*, 153 F. 928.
[25] R., Sec. 741.
[26] *Draper* v. *Sherrett*, 116 F. 206.

quences, where the means of such deception have been supplied by him." [27]

Infringement of Patents. Another form of a wrong, in connection with business transactions, exists in the violation of the rights of a holder of letters patent. A grant of patent entitles the patentee to prevent others for a period of seventeen years from making, using, or selling the particular invention. Any transactions involving these acts constitute an infringement, although they may be innocently done. It is immaterial that there was no intent to infringe, although such a fact may serve to mitigate the damages. An infringement exists, even though all the parts or features of an invention are not taken, if the device constitutes substantial identity of means, operation, and result. In case of a process, however, all successive steps or their equivalent must be taken. In case of a combination of ingredients, the use of the same ingredients with others constitutes an infringement, except when the added ingredients effect a compound essentially different in nature.

> "To infringe a patent, there must be a breach of the right to make, to use, or to vend." (George Close Co. v. Ideal Wrapping Mach. Co., 29 F. [2d] 533)

When an infringement exists, the patentee may recover for any actual loss or injury in an action at law for damages. This is a purely statutory right, and the judge is authorized to render a judgment for double or treble damages at his discretion. In equity the patentee may secure an injunction to restrain the wrongful acts and may recover not only damages but also profits made by the infringer.[28]

Infringement of Copyright. A wrong similar to the infringement of patents is the infringement of copyright. A copyright is the right given by statute to prevent others for a limited time from printing, copying, or publishing a production resulting from intellectual labor. The right exists for a period of twenty-eight years, and it can be renewed for an additional period of twenty-eight years.

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[27] *Forster Mfg. Co.* v. *Cutter-Tower Co.*, 211 Mass. 219, 97 N. E. 749.
[28] *Mason's U. S. Code.* Title 35. §70.

"The great purpose of a copyright is to secure to authors and artists the financial fruits of their own mental labors." (Harris v. Coca-Cola Co., 73 F. [2d] 370)

Patents and copyrights differ in respect to the extent of the protection afforded by the statutes. "The protection afforded by the patent law is broader in the case of patents than in that of copyright. By a grant of a copyright the owner of the work acquires the exclusive right to multiplication of copies; by a grant of a patent the patentee acquires the exclusive right to make and use the thing patented. The patent law protects the production and use of the creative conception reduced to practical shape in various forms; the copyright law protects the publication of copies in the form or substance of the particular creative conception in which it has been expressed by its author." [29]

Infringement of copyright in general consists in copying the form of expression of ideas or conceptions. There is no copyright in the idea or conception itself, but only in the particular way in which it is expressed. In order to constitute an infringement, the production need not be entirely reproduced, or be exact. Substantial reproduction, although paraphrased or otherwise altered, of some part of the original constitutes an infringement. Although appropriation of a word or of a line is insufficient, it is quite clear that an appropriation of all or of even a substantial part of the production is unnecessary to amount to an infringement.

One guilty of infringement of copyright is liable to the owner for damages and profits, or only damages, which are to be determined by the court. The owner is also entitled to an injunction to restrain further infringement. Lack of intent to do wrong has no bearing on the question of infringement; hence it is no defense.

QUESTIONS

1. Decker sells an old picture to Brighton under the impression that it is of little value. Brighton knows that the picture is by a famous artist and is very valuable. Can Decker complain of the fact that Brighton did not disclose this knowledge?

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[29] *Holmes* v. *Hurst*, 174 U. S. 82, 48 L. Ed. 904.

2. Lundy buys one hundred shares of stock of a corporation in reliance upon Doran's representation that the company will make a profit of one million dollars during the next year. The company earns only one half of that amount, and Lundy sues Doran for damages. Is he entitled to recover?

3. Stillman purchases an automobile in reliance upon Merritt's statement that he believes the machine to be mechanically in reasonably fit condition. Merritt really believes that the machine is in poor mechanical condition, and it turns out that it is. Stillman sues Merritt for damages. Is the latter liable?

4. Lorenz tells Reydon that he is contemplating a certain business venture and asks whether such is legal. Reydon states falsely that it is. May Lorenz maintain an action for damages against Reydon?

5. Cottrell asks Swain whether a certain company is financially solvent. Swain, in good faith, replies affirmatively although he actually knows nothing of its affairs. May Cottrell base an action of deceit upon the statement?

6. Little sues Brenneman for infringement of copyright. Little proves that the same idea is expressed in Brenneman's play, although the words and setting are entirely different. Is Little entitled to judgment?

7. Evans intentionally misrepresents a fact to Trainor. Durand is sitting nearby and overhears the statement. If Durand acts in reliance upon the statement, may he recover damages from Evans?

8. Webster and Massinger are in a room discussing business. The former, knowing that Marston is listening at the keyhole and intending him to hear, tells Massinger that his company has just struck a rich vein of ore containing gold. Marston in reliance upon the statement buys stock in the company. It turns out that the company had not been operating its mines for some time and this fact was known to Webster. Is Marston entitled to sue the latter for damages?

9. LeRue tries to persuade Corrigan to buy some stock by falsely stating that the company owns an oil well. Corrigan learns that his cousin is on the board of directors and for that reason buys one hundred shares of stock in the company. The stock proves to be of little value, and Corrigan sues LaRue for damages. Is Corrigan entitled to judgment?

10. Usher possessed a gilded stone which he represented to be a gold nugget. Carisbrooke, in reliance upon Usher's statement, purchased the stone. When Carisbrooke discovered the fraud, he brought an action for deceit against Usher. The latter proved that Carisbrooke was unduly credulous and had frequently purchased "gold bricks." Was Carisbrooke entitled to damages?

11. Falkland was negotiating a sale of a house and lot to Eton. Marvell, for the purpose of vexing Falkland, told Eton of a mortgage which he had on the property. For this reason Eton refused to buy the property. Falkland sued Marvell for slander of title. Was he entitled to judgment?

12. Tilden manufactures automobile tires and wishes to adopt the word "safety" as a trade-mark for such product. May he do so?

13. Vollmer has acquired the word "notamiss" as a trade-mark for spark plugs. Cutter starts to manufacture spark plugs and adopts the word "nevermiss." Does this constitute an infringement of Vollmer's mark?

14. Hanover adopts a trade-mark in the form of two crossed rifles. Stair, who manufactures and sells the same kind of goods, adopts as a trade-mark two crossed shotguns. If Stair's mark constitutes an infringement of Hanover's mark, what are the latter's rights?

15. A firm in Chicago has used the word "Chicago" on its watches for a period of fifty years. Another firm begins to use the same word on its watches, claiming that it is a geographical name and cannot be protected as a trade-mark. The first company attempts to secure an injunction to restrain the second company from using the word. Should the injunction be granted?

16. Gorgas constructed the front of his candy store to represent a log cabin. Later Rogers, who also sold candy, remodeled his store front so that it resembled a log cabin. Gorgas sought an injunction against Rogers. Was the former entitled to the injunction?

17. Martin adopts a container for his products which closely resembles the box used by Dillman for the marketing of goods of the same nature. Martin resists an injunction brought by Dillman on the ground that a dealer in such goods can easily distinguish the goods of each party. Is this a valid defense?

18. Carson sues Burnett for damages resulting from the making and selling of an article which he invented. Burnett offers to prove that he had no intention of infringing on Carson's patent. Is this a valid defense?

CASES FOR REVIEW

1. A thief stole certain mules from C. B. Whiteus, who lived near Dumright, Oklahoma, and sold them for $300 to Frank Clark, a bona fide purchaser. Shortly thereafter, Clark sold the animals to Davis & Younger, who exported the mules. Whiteus brought an action against Clark to recover the value of the mules. Was Whiteus entitled to judgment? (Clark v. Whiteus, 69 Okla. 318, 171 P. 746)

2. The Nestor Johnson Manufacturing Company for a long period of time made and sold tubular skates, which were originated by Nestor Johnson, a skater of great skill and ability. The skates were marked with the name of the company and had become known as the Johnson skates. The name Johnson gained a meaning that described the particular make of tubular skates of the Nestor Johnson Manufacturing Company. Thereafter the Alfred Johnson Skate Company was formed by some former employees to make and sell skates with the name and the markings so similar that confusion resulted. The Nestor Johnson Manufacturing Company brought an action to restrain the new company from using the name Johnson in such a way as to cause a confusion in the products. Was it entitled to judgment? (Nestor Johnson Mfg. Co. v. Alfred Johnson Skate Co., 313 Ill. 106, 144 N. E. 787)

3. Catherine L. Henby brought an action against the Indianapolis Traction & Terminal Company to recover damages for injuries sustained in a streetcar accident. The jury failed to reach a verdict. Before the second trial, an agent of the company procured the prosecution of the plaintiff for perjury, but failed to tell the state's attorney that she had been mentally unsound since the accident. In an action brought by Catherine against the company for malicious prosecution, the company defended upon the ground that it had acted upon advice of counsel, the state's attorney. Was this a valid defense? (Indianapolis Traction & Terminal Co. v. Henby, 178 Ind. 239, 97 N. E. 313)

4. The Western Fruit Grower, a corporation of St. Joseph, Missouri, was engaged in printing and publishing the *Fruit Grower*, a publication issued in the interests of fruit growers. It published a severe criticism of a dust spray, the product of the Dust Sprayer Manufacturing Company. The article stated that the use of the dust injured the trees and killed nearly all the small bearing limbs. The manufacturing company, alleging the article to be false, brought an action to recover damages from the publishing company, but it did not allege and prove damages. Was the Dust Sprayer Manufacturing Company entitled to judgment? (Dust Sprayer Mfg. Co. v. Western Fruit Grower, 126 Mo. A. 139, 103 S. W. 566)

5. The Star Market Company owned a two-story brick building located on the principal business street of the city of Sand Point, Idaho. It was engaged in the smoking of meats, rendering lard, and manufacturing sausages and other meat products. D. G. Lorenzi owned a two-story brick building adjoining the building of the company. He brought an action to restrain the Star Market Company from the maintenance of an alleged nuisance, consisting of the escape of smoke and offensive odors from the building. Was Lorenzi complaining of an alleged nuisance in esse or a nuisance per se? (Lorenzi v. Star Market Co., 19 Ida. 674, 115 P. 490)

6. An employee of the Gulf Refining Company, while unloading a tank car, was emptying the spout at the bottom of the tank into a tub.

An employee of the Nashville Railway & Light Company informed him that a blast was being set off to break some rock in a hole about thirty feet from the tank car. The employee of the refining company immediately ran around the tank car for protection. During his absence the tub overflowed, and the escaping gasoline became ignited and injured the property of J. S. Moody. An action was brought by Moody to recover from the refining company damages arising out of the alleged negligence of the employee of the company. Was Moody entitled to judgment? (Moody v. Gulf Refining Co., 142 Tenn. 280, 218 S. W. 817)

7. Berry was a shoemaker employed by the firm of Hazen B. Goodrich & Company, at Haverhill, Massachusetts. Donovan allegedly induced the company to break the contract of employment. In an action brought by Berry against Donovan to recover damages for the malicious interference with Berry's contract of employment, it was contended that good motives and lack of express malice did not constitute a defense. Do you agree? (Berry v. Donovan, 188 Mass. 353, 74 N. E. 603)

8. As the result of statements in a prospectus, Daniel Donnelly was induced to purchase certain bonds of the Nashville Railway from the Baltimore Trust & Guaranty Company. The circular declared that the population of Nashville "is now variously estimated at from 100,000 to 120,000," whereas the population was only about eighty thousand. It also stated, "Nashville Trade. Valued at more than $1,000,000 annually," whereas such trade was in fact only about half the amount stated. Donnelly brought an action against the Baltimore Trust & Guarantee Company to recover damages. Was he entitled to judgment? (Donnelly v. Baltimore Trust & Guarantee Co., 102 Md. 1, 61 A. 301)

9. Florence W. Whittaker was invited aboard the yacht *Kingdom* by Frank W. Sanford, who controlled the vessel. She was assured by Sanford that she would be returned to shore. Thereafter, however, Sanford refused her request for a boat in which to reach shore from the yacht, which was anchored in the harbor some distance from land. Mrs. Whittaker brought an action against Sanford to recover damages. Was she entitled to judgment? (Whittaker v. Sanford, 110 Me. 77, 85 A. 399)

10. The John Vittucci Company, a dealer in olive oil, had a trademark consisting in part of the map of Italy. Angelo Merline, doing business as the Metropolitan Grocery Company, thereafter began to use the map of Italy on his containers of olive oil. The John Vittucci Company brought an action against Merline to restrain the use of the map of Italy on such containers. Was it entitled to judgment? (John Vittucci v. Merline, 130 Wash. 483, 228 P. 292)

11. John Morgan leased a farm from Simeon O'Daniel. Thereafter Morgan and his wife brought an action against O'Daniel to recover damages arising out of alleged threatening gestures made by O'Daniel toward Mrs. Morgan. The court instructed the members of the jury that if they "believe defendant O'Daniel did not intend or attempt to strike

plaintiff Harriet Morgan with the stick," they should find for the defendant. Was the charge to the jury correctly made? (Morgan v. O'Daniel, 21 Ky. L. 1044, 53 S. W. 1040)

12. A wealthy man, while in the courthouse at Juneau, Dodge County, Wisconsin, and in the presence of a large number of persons, became angry at a woman and spit in her face. Thereafter the woman brought an action against the man to recover damages arising out of an alleged battery. Was she entitled to judgment? (Draper v. Baker, 61 Wis. 450, 21 N. W. 527)

13. Charles Armstrong was a passenger on a streetcar of the Montgomery Street Railway Company. As the result of the negligence of the motorman in suddenly and violently starting the car, Armstrong was thrown from the vehicle and injured. His wounds produced blood poisoning from which he died. In an action brought by L. J. Armstrong, as executor of the estate of Charles Armstrong, against the company to recover damages, the company contended that the fault of the company was not the proximate cause of the death. Do you agree? (Armstrong v. Montgomery St. Ry. Co., 123 Ala. 233, 26 S. 349)

14. A brick thrown over a boundary fence by a child started two neighbors into a verbal bombardment and a skirmish over a ladder that was hanging on the fence. The wife of one of the participants joined in the struggle and, while standing on her side of the fence, reached over the fence to grasp the ladder. During subsequent litigation, the court ruled that the wife was guilty of a trespass. Was the ruling correct? (Hannabalson v. Sessions, 116 Iowa 457, 90 N. W. 93)

15. Theresa Dempsey maintained a trap door opening from the sidewalk in front of her premises into a cellar. The trap door became out of order and did not close properly. Frederick Eberspacker, while negligently walking past the premises, tripped over the projection of the trap door and broke a plate glass window. Mrs. Dempsey brought an action against Eberspacker to recover damages. Was she entitled to judgment? (Dempsey v. Eberspacker, 131 App. Div. 285, 115 N. Y. S. 589)

16. B. F. Speed took dinner at the home of Mr. and Mrs. Furr. Thereafter he allegedly told other persons that "Mrs. Furr poisoned me." An action was brought by Mrs. Furr against Speed to recover damages for false defamation. It was contended that it was unnecessary for the plaintiff to allege and prove damages. Do you agree with this contention? (Furr v. Speed, 74 Miss. 423, 21 S. 562)

CHAPTER XVII

BUSINESS CRIMES

Part I—General Considerations

Introduction. The antisocial conduct of a relatively few members of society takes from business an annual toll in money amounting to hundreds of millions of dollars and causes personal damage in lives and serious injuries to human beings which cannot be adequately computed by financial measurement. In early days losses were largely due to the actions of marauding bands who frequently looted the trading centers. With the establishment of strong governments, these perils gradually vanished. Earlier traders occasionally employed simple artifices for the purpose of perpetrating cheats and frauds. These practices, such as the concealing of stones in hay or other goods which were sold by weight, were usually of a naive character and were easily detected.

Today, however, the man engaged in business is confronted with knaves whose schemes are limited only by human ingenuity. Simple artifices have been replaced by swindling devices of an extremely complicated nature—devices which defy easy detection even by the most prudent man, much less by the more credulous members of a community. Moreover, combinations of various sorts, which seriously threaten the survival of a person engaged in business, have developed. These groups may threaten the existence of a given business merely by means of economic power which they possess by virtue of their combined strength, or by means of force or intimidation. The man in business requires protection from these destructive forces, not only in his own personal interest but also in the interest of society as a whole. The businessman is partly protected from these forces by that part of the law commonly called *criminal law*.

Criminal law is of ancient origin. Some rules for social conduct were probably necessary to establish even the first of the early rude forms of civilization. In a real sense, however, criminal law is of modern origin. The earlier rules of

social conduct were developed to govern an economic life which was entirely different from that of modern time. New conditions have required a modification of many of the old rules and also the establishment of some rules which did not previously exist.

The crimes which affect business, particularly statutory crimes, are so numerous that it will not be possible to mention all offenses here or to discuss them in detail. Some of the more common offenses which seriously affect business will be considered briefly to indicate the nature and trend of acts which are classed as business crimes.

Definition. In a broad sense, any act or omission which is a violation of a public duty, for which a penalty or punishment is imposed by the state, is a *crime.* This term, however, is frequently employed to designate only violations of duty which amount to offenses of a more serious nature. As one court says: "There is a wide difference between the perpetration of a crime and the violation of a corporation ordinance. The former implies moral turpitude, and is presumed to be committed malo animo; whereas the latter involves no moral guilt, and may have been inadvertently, nay innocently, committed. The omission to remove the snow and ice from the sidewalks of a populous city may be as much a violation of a corporation ordinance, to which a penalty is attached, as to ride a horse upon the sidewalks of the same city. Neither of them is a crime, and no one conversant with the nature and principles of criminal law would regard, or think to punish, them as crimes." [1]

> "One may be guilty of a moral wrong and not be guilty of a crime." (Simmons v. Victory Life Ins. Co. of Louisiana, 18 La. A. 660, 139 S. 68)

A crime should be distinguished from a tort. The latter is a wrong against one or more members of society, whereas the former is a wrong against the public, or, in other words, a wrong against the state or society as a whole. To illustrate, "If I detain a field from another man, to which the

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[1] *Schneider* v. *McLane*, 36 Barb. (N. Y.) 495.

law has given him a right, this is a civil injury, and not a crime; for here the right of an individual is concerned, and it is immaterial to the public which of us is in possession of the land; but treason, murder, and robbery are properly ranked among crimes; since besides the injury done to individuals, they strike at the very being of society, which cannot possibly subsist where actions of this sort are suffered to escape with impunity." [2]

A crime and a tort may be distinguished on other grounds. Although the state recognizes both as wrongs, it attaches different effects to the acts or omissions. In case of a crime, the state may bring an action to enforce a prescribed penalty or punishment. On the other hand, when an act or omission is a tort, the state allows an action for redress by the injured party. It should be noticed that the same act may constitute both a crime and a tort, as in the case of the theft of an automobile.

Classification. Crimes may be divided into several classes. They may be classified in terms of their origin, in terms of their seriousness, or in terms of their nature.

Origin. Crimes are classified in terms of their origin as *common-law* and *statutory* crimes. The first class includes such offenses as are recognized and punished by courts of common law. The second embraces all crimes which have been defined by acts of legislatures. In this connection it must be remembered that some offenses which are defined by statute are merely declaratory of the common law.

> In some states all crimes are statutory, hence in such jurisdictions "there are no common-law crimes." (State v. Flory, 203 Iowa 918, 210 N. W. 961)

Seriousness. Crimes are classified in terms of their seriousness as *treason, felonies,* and *misdemeanors.* Treason, generally speaking, is an attempt to overthrow or betray the government to which a person owes allegiance. In some countries it is considered an offense against the sovereign, and it may consist of a serious attack upon one of several state

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[2] *4 Blackstone Comm.,* p. 5.

officers. In this country the offense is defined by the Constitution of the United States. It states that "treason against the United States shall consist only in levying war against them, or in adhering to their enemies, giving them aid and comfort." [3]

The second class includes the other more serious crimes, such as arson, homicide, and robbery. At common law the test of a felony was whether the offense was punishable by a forfeiture of property. Today the test commonly applied is whether the crime is punishable by confinement in prison or by death. In case of statutory crimes the seriousness of the offense depends upon the terms of the statute. In some instances a statute may convert an act, previously a minor offense, into a felony. Although the use of the term *felonious* does not make the act a felony, if the terms of the statute expressly declare the act to be a felony, it is considered such and the mode of punishment is immaterial. For example, when the punishment for a felony is changed from death to imprisonment, the character of the act remains unchanged.[4]

> "The rule generally is that an offense is a felony if it may be punished by imprisonment in the penitentiary, regardless of what penalty is imposed." (Seitz v. Ohio State Medical Board, 24 Ohio A. 154, 157 N. E. 304)

Indictable offenses not classed as felonies are *misdemeanors*. In some states, misdemeanors are classified as high misdemeanors and petty misdemeanors. If the statute expressly declares that an offense is a misdemeanor, the mode of punishment is immaterial. It is clear, from what has been said, that an act may be deemed a felony in one state and a misdemeanor in another.

Nature. Crimes are classified in terms of the nature of the misconduct, as crimes *mala in se* and crimes *mala prohibita*. The first class includes acts which are inherently vicious, or, in other words, which are naturally evil as measured by the standards of a civilized community. The second class includes those acts which are wrong merely because they are declared wrong by some statute. "For the reason

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[3] *Art. III*, §3.
[4] *State* v. *Rowley*, 42 S. C. 17, 19 S. E. 1018.

that acts mala in se have, as a rule, become criminal offenses by the course and development of the common law, an impression has sometimes obtained that only acts can be so classified which the common law makes criminal, but this is not at all the test. An act can be, and frequently is, malum in se, when it amounts only to a civil trespass, provided that it has a vicious element, or manifests an evil nature, or wrongful disposition to harm or injure another in his person or property." [5]

Responsibility for Acts. Under certain circumstances, a person may be excused from responsibility for an act which would otherwise entail punishment. Such circumstances exist when a person lacks the capacity to do a criminal act, as in the case of certain infants, insane persons, corporations, or intoxicated persons.

Infants. Some states have legislation fixing the age of criminal responsibility of infants. At common law, when "a child is under the age of seven years, the law presumes him to be incapable of committing a crime; after the age of fourteen he is presumed to be responsible for his actions as entirely as if he were forty; but between the ages of seven and fourteen, no presumption of law arises at all, and that which is termed a malicious intent—a guilty knowledge that he was doing wrong—must be proved by the evidence, and cannot be presumed from the mere commission of the act." [6]

Insane Persons. An insane person is not criminally responsible for his acts, because he cannot form a criminal intent. There is a conflict of opinion as to what constitutes such insanity as to excuse a person from the normal consequence of his acts. All courts, however, agree that intellectual weakness alone is not such insanity. A test commonly applied is the right and wrong test. Thus, the responsibility of the defendant is determined in court in terms of his ability to distinguish right from wrong in relation to the act committed.[7] Some courts also use the irresistible impulse test.

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[5] *State* v. *Horton*, 139 N. C. 588, 51 S. E. 945.
[6] *Regina* v. *Smith*, 1 Cox C. C. 260.
[7] *State* v. *Lewis*, 20 Nev. 333, 22 P. 241.

The essence of this theory is that, although the defendant may know right from wrong, if he acts under an uncontrollable impulse because of an unsound state of mind, he has not committed a voluntary act. When insanity takes the form of delusions or hallucinations, the defendant is not legally responsible when the imagined facts, if they were true, would justify the act. For example, when a person seriously injures another person under the delusion that he is being attacked and is acting in self defense, there is no criminal responsibility.[8]

> "Where an adult person has the intelligence of a child from 7 to 9 years of age, that fact alone cannot be made the test as to whether he is insane." (Chriswell v. State, 171 Ark. 255, 283 S. W. 981)

Corporations. It was thought at one time that a corporation could not commit a crime by affirmative act, because such an act would be beyond its authorized powers. The modern tendency, however, is to hold corporations criminally responsible for their acts. This is especially true when the act is within the scope and object of the corporation and is committed by its officers. An act of the directors within the scope and purpose of the corporation is an act of the corporation. "If they do any injury to another, even though it necessarily involves in its commission a malicious intent, the corporation must be deemed by imputation to be guilty of the wrong, and answerable for it, as an individual would be in such case." [9] Most courts have held, however, that a corporation cannot commit wrongs involving specific evil intent, such as murder. Other crimes, such as bigamy or perjury, cannot be committed by corporations. It is also usually held that statutory crimes punishable by imprisonment do not apply to corporate bodies.

Intoxicated Persons. Involuntary intoxication relieves a person from criminal responsibility. On the other hand, voluntary intoxication does not. "It is a duty which every one

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[8] *Smith* v. *State*, 55 Ark. 259, 18 S. W. 237.
[9] *United States* v. *John Kelso Co.*, 86 F. 340.

owes to his fellow-men and to society, to say nothing of more solemn obligations, to preserve, so far as it lies within his own power, the inestimable gift of reason. If it is perverted or destroyed by fixed disease, though brought on him by his own vices, the law holds him not accountable. But if by a voluntary act he temporarily casts off the restraints of reason and conscience, no wrong is done him if he is considered answerable for any injury which in that state he may do to others or to society." [10] An exception to this rule is made in case of crime requiring specific intent when the accused was so intoxicated that he would have been incapable of forming such intent.

Parties. Two or more parties may directly or indirectly contribute to the commission of a crime. At common law, participants in the commission of a felony are sometimes known as *principals* and *accessories*. This distinction has been abolished by statute in many states. These classes do not as a general rule exist in case of a misdemeanor. In this case the parties, if liable at all, are responsible as principals.

> "Where two or more persons act in concert in the commission of an unlawful act, the act of one is the act of all." (State v. Friedman, 313 Mo. 88, 280 S. W. 1023)

Principals. Principals to a crime are divided into two classes, principals *in the first degree* and principals *in the second degree.* A principal in the first degree is a person who actually engages in the perpetration of the crime. A principal in the second degree is a person who is actually or constructively present and aids and abets in the commission of the act. For example, a person is a principal in the second degree if he asists by words of encouragement, stands ready to assist or to give information, or keeps watch to prevent surprise or capture.[11]

Accessories. Accessories to a crime are also divided into two classes, accessories *before the fact* and accessories *after the fact.* An accessory before the fact differs from a principal

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[10] *People* v. *Rogers*, 18 N. Y. 9.
[11] *State* v. *Davenport*, 156 N. C. 596, 72 S. E. 7.

in the second degree only by reason of his absence from the scene of the act. An accessory after the fact is a person who knowingly assists the perpetrator of a felony. To illustrate, a person is an accessory after the fact if, with intent to assist a felon, he gives warning to prevent arrest or aids in an escape from imprisonment.[12]

Prevention of Crimes. The usual method employed to prevent crime is punishment. This may take the form of fines, pain, imprisonment, or other penalties. The theory of punishment is that it will restrain other persons from committing the prohibited act and the wrongdoer from repeating the offense. As one court says: "Hatred and revenge enter largely into punishment among barbarians and savages; but among civilized people punishment is only inflicted for the purpose of protecting society, and not for revenge. In other words, the law never seeks a victim, but only seeks to reform the offender and set an example which will deter others from committing similar offenses, and by both of these means it seeks to protect society." [13]

In the absence of constitutional restrictions, it is within the power of the legislature to prescribe any form of punishment for crime. Practically all, if not all, state constitutions contain limitations on this power of the legislature. These restraints vary, but there are usually provisions similar to the limitation in the Federal Constitution which prohibit "excessive fines" and "cruel and unusual punishments." [14]

Although punishment by fines or imprisonment is usually employed to prevent crime, there are other methods which are used to attain this end. Statutes sometimes require a restitution of property which has been stolen or the payment of damages to the owner upon conviction of larceny. At common law, courts may require a bond to secure the future good behavior of a person who has been convicted of a serious misdemeanor. Statutes sometimes authorize the requirement of a bond for this purpose when a person has been convicted two or more times of violating a specific law.

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[12] *Dent* v. *State*, 43 Texas 639.
[13] *Lyons* v. *State*, 6 Okla. 581, 52 P. 1134.
[14] *Eighth Amendment.*

QUESTIONS

1. "It is impossible to make an exact estimate of the losses to business which are caused by the antisocial conduct of a relatively few members of society." What is meant by this statement? Do you agree?

2. Stewart and Hindman are discussing the necessity of governmental intervention in business. The former contends that the requirements of a man in business as to protection against the antisocial conduct of some members of society were as great in early days as they are today. Do you agree?

3. "In a real sense, criminal law is of modern origin." What is meant by this statement?

4. A given city has an ordinance which prohibits riding a bicycle on the sidewalk and imposes a fine of five dollars for a violation of this regulation. Steele, while riding upon one of the city sidewalks, is arrested and fined. Is he guilty of committing a crime?

5. A statute in a given state gives a landowner the right to bring an action for damages against trespassers. Forsyth wrongfully enters upon and occupies Jordan's property for a period of thirty days. Jordan contends that this act renders Forsyth criminally liable under the foregoing statute. Is his contention sound?

6. Blake committed an offense for which he was tried, convicted, and sentenced to ten years in a state penitentiary. After being released, he was convicted of committing a felony. At this trial he was sentenced to serve a maximum term in the penitentiary on the ground that he had committed a second felony. Blake contended that his first offense was a misdemeanor. Was his contention sound?

7. "Only acts which have become criminal by the course and development of the common law can be classified as acts mala in se." Do you agree with this statement?

8. Curwood was violently thrown from his horse during a steeplechase. Thereafter he was subject to hallucinations and delusions. One day he killed his friend, Percival, while under the impression that the latter was a wild animal which was about to attack him. Was Curwood criminally liable for this act?

9. Farnum contends that at common law all infants were criminally liable for their acts. Dermouth denies this, contending that at common law infants were not criminally liable for their acts. Do you agree with Farnum or Dermouth?

10. Delavan makes elaborate plans to commit a felony against Parker. Among other precautions taken, he requests Marks to remain near to give warning in the event of the approach of any one. Delavan is surprised in the commission of the felony, and both he and Marks are captured. Are Delavan and Marks both liable as principles in the first degree at common law?

Part II—Crimes against the Person

Assault and Battery. At common law, and usually by statute, assault and battery are criminal offenses. An *assault* is an offer or attempt to do violence to the person of another. A *battery* is an assault carried into execution. An assault and a battery are two distinct crimes, although they usually occur together. They are often embraced in the one term *assault.*

> "In this case the felonious assault was charged to have been by beating, bruising, and wounding the prosecuting witness with certain rocks and clubs." (State v. Burkhart [Mo. A.] 34 S. W. [2d] 563)

The elements of criminal assault differ from those of civil assault which gives rise to an action for damages in tort. There must be an actual intention to injure or, at least, to alarm another, and this cannot be proved by what the other party believes. Courts are in conflict as to whether apparent ability to carry out the threat is sufficient to establish a criminal action of assault. One court states: "The adjudged cases, both in this country and in England, are not agreed, and a like difference of opinion prevails among the most learned commentators on the law. We have had occasion to examine these authorities with great care, on more occasions than the present, and we are of the opinion that the better view is, that presenting an unloaded gun at one who supposes it to be loaded, is not, without more, such an assault as can be punished criminally, although it may sustain a civil action for damages." [1] It should be borne in mind that a civil action of assault is based upon the invasion of another's right to live without his being placed in fear of personal injury, whereas a criminal action of assault is based upon an intention to do violence to the person of another.

Kidnapping. The unlawful detention and removal of a person to another place is a common-law offense known as *kidnapping.* In most states such conduct is also made a felony by statutes, the provisions of which differ materially.

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[1] *Chapman* v. *Camp,* 78 Ala. 463.

One essential element of this offense is ordinarily the unlawful custody or transportation of a person, or both. For example, the detention and removal of a person to an insane asylum by means of lawful procedure is not kidnapping.[2] Another element of the offense is detention against the consent of the person detained. This element, however, is not necessary when the party is not capable of giving consent. To illustrate, a person may be guilty of kidnapping an insane individual or a very young child, although the person goes willingly, as neither is legally capable of consenting to a detention.[3]

> When a person unlawfully jumped on the running board of an automobile and forced the driver to take him where he wanted to go, his acts "constituted the felony of kidnapping." (State v. Antheman, 47 Ida. 328, 274 P. 805)

Ordinarily, force and violence are unnecessary to the commission of the offense. This is true even when the statute defines the crime in terms of force. In some states, statutes have made enticement, fraud, or inveiglement sufficient means to establish the commission of the crime. It is immaterial that the person is openly seized and detained, unless the statute prescribes secrecy as an element. The place where the person is seized and the place to which he is carried are ordinarily immaterial. The fact that the person escapes or is not detained for a long period of time does not affect the consummation of the crime.

Extortion. At common law *extortion* is the unlawful taking of money or property by an officer of the law by virtue of his office. Duress is not a necessary element of the offense. It is sufficient if an officer, in his official capacity, requests and receives money or other things of value which are not due him in the amount or at the time. One court stated: "There is certainly no right in a prison-keeper to demand a fee for letting a man out of prison the moment he is put in, and it is extortion at common law to receive, by color of office, a fee before it is due, though no more is taken than will in all

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[2] *People* v. *Camp*, 66 Hun. 531, 21 N. Y. S. 741.
[3] *State* v. *Marks*, 178 N. C. 730, 101 S. E. 24.

probability soon become due, and the common law is not repealed by the statute which prescribes and limits the penalty." [4] Under statutes in many states the offense of extortion includes any taking of property by force or intimidation.

> Under some statutes the crime of extortion may be committed by an officer "or any person employed by such officer." (Murray v. State, 125 Tex. Cr. 252, 67 S. W. [2d] 274)

Extortion differs from robbery. In the latter crime, property is taken against the will of the possessor. In the former, the property is taken with the consent of the person, although by force or fear, as in robbery. Extortion has always been considered a very serious offense. Thus, one court declared that "it is more odious than robbery, for robbery is apparent and has the face of a crime; but extortion puts on the vizor of virtue, and it is ever accompanied by the grievous sin of perjury." [5]

Homicide. Generally speaking, *homicide* means the taking of the life of one person by another. It may be lawful or unlawful. In the latter case, the act may constitute murder or manslaughter.

Murder. At common law *murder* is defined as the killing of a human being by another with malice aforethought. The words *malice aforethought* are defined in many ways. The generally accepted meaning of the words is that there existed previously or at the time of the act or omission by which death was caused, a state of mind bent upon mischief without thought of social duty. Stated more simply, malice aforethought means intentional killing without legal excuse or justification. Thus, one court states that malice aforethought "is manifested by the doing of an unlawful and felonious act intentionally and without legal excuse. It does not imply a pre-existing hatred or enmity toward the individual injured." [6] Some states have two or more degrees of murder. In most of these states the crime is classified as first- and second-degree

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[4] *Commonwealth* v. *Bagley*, 7 Pick. (Mass.) 279.
[5] *Commonwealth* v. *Rodes*, 1 Dana (Ky.) 595.
[6] *People* v. *Balkwell*, 143 Calif. 259, 76 P. 1017.

murder. Murder in the first degree includes homicides which accompany certain felonies, such as arson and robbery, or which are perpetrated in a certain manner, as by poison or by lying in wait.

> After establishing that a homicide is unlawful, to be murder in the first degree, "there must be added to unlawfulness malice, deliberation, and premeditation." (Macias v. State, 36 Ariz. 140, 283 P. 711)

Manslaughter. At common law *manslaughter* is defined as the unlawful killing of a human being by another without malice. Manslaughter may be voluntary or involuntary. The former exists when one person, acting under provocation, kills another in sudden heat of passion. For example, a person who is assailed with violence and in sudden anger fatally attacks his assailant with a dangerous weapon is guilty of manslaughter.[7]

Involuntary manslaughter occurs when a person, while engaged in an illegal act which is not felonious, or, while negligently performing lawful acts, kills another. The latter is particularly important in business transactions. Involuntary manslaughter occurs when persons are killed as a result of a person's negligence in operating trains, machinery, or vehicles. A person may be guilty of manslaughter for negligence in the construction of a building, which results in the loss of life. Statutes often specify that certain persons shall be guilty of manslaughter under circumstances in which there is a loss of life. To illustrate, Congress has enacted that "every captain, engineer, pilot, or other person employed on any steamboat or vessel, by whose misconduct, negligence, or inattention to his duties on such vessel the life of any person is destroyed, and every owner, charterer, inspector, or other public officer, through whose fraud, neglect, connivance, misconduct, or violation of law the life of any person is destroyed, shall be fined not more than $10,000, or imprisoned not more than ten years or both." [8]

Mayhem. The crime of *mayhem* consists of unlawfully and violently causing serious injury to the body of another so as

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[7] *Commonwealth* v. *Webster*, 5 Cush. (Mass.) 295.
[8] *United States Code*, 1940, Title 18, §461.

to disfigure him or to render him lame or defective in bodily vigor. This offense, sometimes called maiming, is defined in various ways both at common law and by statutes. At common law it is usually defined in terms of rendering a person unfit for combat. Thus, mayhem has been defined as "violently and unlawfully depriving another of the use of a member proper for his defense in fighting." [9]

> Biting off the ear of the host by a guest at a party constituted the crime of mayhem. (People v. Foster, 3 Calif. A. [2d] 35, 39 P. [2d] 271)

Statutory definitions frequently include such words as *willfully, intentionally, purposely,* or *maliciously.* To illustrate, it is stated that "to maim is to willfully and maliciously cut off or otherwise deprive a person of the hand, arm, finger, toe, foot, leg, nose or ear; to put out an eye; or in any other way to deprive a person of any other member of his body." [10] Under modern statutes the importance of the member of the body in relation to military fitness is not stressed.

In some states mayhem is a felony. In others, the offense is punished merely as a misdemeanor. In still other states the offense is treated as either a felony or a misdemeanor, according to the seriousness of the injury and other circumstances.

Arson. The malicious and willful burning of the house of another by day or night is a common-law felony known as *arson.* This offense was originally and is still regarded as primarily a wrong against the person, although it has been extended to protect rights in property.

At common law the crime of arson required the burning of a house actually occupied by human beings, or of structures near such a house. By statutes in many states the offense includes the burning of structures other than the dwelling. To illustrate, arson is sometimes defined by statutes to include public buildings, buildings used for specific purposes, or buildings used for general commercial purposes.[11]

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[9] *Commonwealth* v. *Newell,* 7 Mass. 245.
[10] *Texas Penal Code,* 1920, Title 15, Art. 1033.
[11] *People* v. *Shainwold,* 51 Calif. 468.

Under some statutes the burning of a building by the owner with the intent to defraud is arson, but under most statutes this act is a separate and distinct offense. The extent of the burning is immaterial, but there must be an actual ignition of the structure. For example, when a person sets fire to the goods in a building, but the fire is not communicated to the structure, he is not guilty of arson.[12]

QUESTIONS

1. While quarreling with Patterson over the sale of some sheep, McConaghey knocks him down and starts homeward. Patterson rushes into a hardware store nearby and purchases a shotgun and shells for the purpose of killing McConaghey. After making the purchase, Patterson pursues McConaghey, and as soon as he overtakes him continues the argument over the sheep but does not make any threat against McConaghey with the firearm. It is contended that Patterson is criminally liable for an assault against McConaghey. Do you agree?

2. Hunter and Ward have been bitter enemies for several years. The former, who owns and operates a drug store, places some poison in candy which a friend orders sent to Ward. Ward, after eating the candy, becomes ill as the result of the poison. Is Hunter criminally liable?

3. Brunker proffers hard liquor to Randolph. When the latter is intoxicated, Brunker places him on board a ship which is about to sail for foreign ports. Randolph, after regaining full use of his senses, is compelled to work as a seaman. Upon his return, he enters a complaint of kidnapping against Brunker. Is Brunker guilty of this offense?

4. Matthews, a police officer, arrests Rathbun under a warrant and confines him until he is released by a court. Rathbun contends that the officer is guilty of kidnapping, alleging that he was imprisoned and detained without just cause. Matthews proves that the arrest was made under a valid warrant, issued by the proper officer. Is he guilty of the offense?

5. An officer was allowed by law to use his discretion in giving bail to persons arrested. Peterson is arrested upon a minor charge. The officer accepts fifty dollars from Peterson in return for allowing him to leave jail. It is alleged that the officer is guilty of extortion. Do you agree?

6. McKellar secures a writ of execution against the property of Tilden to satisfy a judgment of five hundred dollars obtained against the latter. The constable who executes such writs is entitled to a sum, to be determined by the justice, for receiving and caring for the prop-

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[12] *Graham* v. *State*, 40 Ala. 659.

erty on which the levy is made. Before this sum is determined by the justice, the constable requires McKellar to pay him five hundred dollars. A complaint is entered against the constable, alleging extortion. Is he guilty of this offense?

7. Upon a complaint made by Kimes, Arden is fined five dollars for maintaining a public nuisance upon his premises. To secure revenge, Arden makes a bomb and places it in a container so that an explosion will occur when it is removed. He sends the bomb through the mail to Kimes. Because of Kimes's absence from the city, his partner, Bates, opens the package and is killed by the explosion of the bomb. A charge of murder is brought by the state against Arden. Is he guilty of this offense?

8. Fisher and Shadlow met in front of the latter's home and engaged in a violent quarrel over the damage sustained by Fisher because of Shadlow's cattle escaping from the adjoining pasture. After an exchange of many heated words, Fisher suddenly drew a revolver, shot at Shadlow, and immediately ran down the road. Shadlow stepped into his home, seized a rifle, and fired and killed Fisher who, while still running, was not out of the range of the gun. Shadlow was brought to trial for murder. Was he guilty of this offense?

9. Duff is on a vacation at a summer resort. One day at the beach he volunteers to teach a boy how to swim. The latter agrees, but refuses to leave the shallow water. Duff drags the boy against his wish into deep water, and the boy is drowned. What charge, if any, can be made against Duff?

10. Purcell is an unsuccessful beggar. Thinking that if he were a cripple, he could more easily prey upon the sympathies of the public, he consults a doctor for the purpose of having an arm and a leg amputated. The doctor performs the operation. Later the doctor is arrested upon a charge of mayhem. Is he guilty of this offense?

11. Sidley owns a farm upon which Haley lives as a tenant. Two days before the end of his lease, Haley moves from the premises. Before the new tenant takes possession of the property, Donnel destroys the farmhouse by fire. Donnel is arrested and tried upon a charge of arson. Is he guilty of this offense under the common law?

Part III—Crimes against Property

Burglary. At common law the offense of *burglary* consists in the breaking in and entering of a dwelling house of another during the night with an intent to commit a felony. In order that the offense of burglary be established, it is necessary that the wrongdoer break in and enter a building in which some member of the family or a servant regularly sleeps, as this crime is considered an offense against the dwelling house.

The term *dwelling house* also includes buildings, such as barns and meathouses, in close proximity and easily accessible, on the theory that "the capital house protects and privileges all its branches and appurtenances, if within the curtilage and homestead." [1] Under statutes, burglary has been extended to include the breaking in and entering of buildings other than such as are used for habitation, such as stores, warehouses, and boxcars. Under such legislation, burglary is an offense against property.

> A movable sheep wagon, occupied by a sheep herder as a residence, was held to be within the meaning of "house" as used in a burglary statute. (State v. Ebel, 92 Mont. 413, 15 P. [2d] 233)

Another essential element of burglary is a breaking in. There must be some degree of force, however slight, applied to effect an entrance. To illustrate, entering a house through an open transom, or pushing open an unlocked door is a breaking in.[2]

A third essential element of the offense is an entry. It is sufficient, however, if there is an entry of any part of the body, as the head or a foot. For example, if a person breaks a window pane and merely reaches through the opening to remove the goods, there is an entry. An entry may also be made by means of an instrument, as a hook directed by the wrongdoer, although no part of the body enters the building. It is not necessary that the breaking in and entering be on the same occasion.

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[1] *State* v. *Vierck*, 23 S. Dak. 166, 12 N. W. 1098.
[2] *State* v. *Boysen*, 30 Wash. 338, 70 P. 740.

A fourth essential at common law is that the breaking in and entering must be at night. An offense is deemed to have occurred during the night if it happened between sunset and sunrise when it was impossible to discern a face. The fact that light from street lamps, windows, or the moon made it possible to discern the person's face is immaterial. Thus one court states: "The malignity of the offense does not so properly arise from its being done in the dark, as at the dead of night, when all creation, except beasts of prey, are at rest, when sleep has disarmed the owner and rendered his castle defenseless." [3] By statute in many states the offense of burglary may be committed in the daytime.

Larceny. At common law the offense known as *larceny* consists of the wrongful carrying away of personal property belonging to another with the intent to convert it to the use of the taker.[4] The crime has been defined in many ways by both courts and statutes. Thus, the crime has sometimes been stated to consist of "the felonious stealing, taking and carrying, riding or driving away of personal property of another." [5] Under modern statutes any form of personal property may be the subject matter of larceny, including such things as coins, paper money, bonds, documents, water, gas, and parts of realty which may be severed and carried away. The crime of larceny is sometimes classified as *grand* larceny and *petit* larceny. The former is committed when the value of the property stolen exceeds an amount specified by statute. If the value is less than this amount, the offense is petit larceny.

There are three essential elements of the crime of larceny. First, the offense can be established only by showing a trespass against some rights of another in the goods taken. A person is, of course, not guilty of larceny when he takes his own goods. Larceny may occur, however, when he takes from another some special property in which the latter has only

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[3] *People* v. *Arnold*, 6 Park (N. Y.) 638.

[4] In most states the wrongful taking of an automobile for temporary purposes, such as a "joy ride," does not render the wrongdoer liable for the crime of larceny. To abate this growing evil, many states have enacted statutes making such unauthorized takings of automobiles a crime.

[5] *Ridgel* v. *State*, 110 Ark. 606, 162 S. W. 773.

the right of possession, as in the case of a bailment. Although larceny is often defined in terms of a trespass against ownership, the latter term is used in the sense of right to immediate possession.

> When a defendant was charged with the larceny of a steer, because, among other things, he had in his possession four quarters of beef, the court declared: "If defendant took the meat knowing the animal had been stolen by another or others, he would not thereby be guilty of larceny of the animal." (State v. Guffey, 57 S. D. 111, 230 N. W. 850)

The second element of the offense is that the property must be taken from the possession of the owner or person entitled to possession, into the possession of the wrongdoer. If, therefore, a person pushes another so that the latter drops the property, but is frightened away before picking it up, the wrongdoer is not guilty of larceny. In this case he has not gained possession and control of the property. When, however, possession and control of the property are obtained, it is immaterial that such possession and control exist only for a short period of time.

The third element of the offense is that the property must be carried away. Asportation or the carrying away of the goods consists of making any change in the position of the property, as drawing liquids from casks or of merely moving a purse which is loose in a man's pocket without extracting it. "The least removal of the thing taken from the place where it was before is sufficient asportation though it be not quite carried off. Upon this ground the guest, who having taken the sheets off his bed with an intent to steal them, carried them into the hall and was apprehended before he could get out of the house, was adjudged guilty of larceny. So also was he, who having taken a horse in a close with the intent to steal it, was apprehended before he could get it out of the close. And such was the case of him who, intending to steal plate, took it out of the trunk wherein it was, and laid it on the floor, but was surprised before he could remove it any farther." [6]

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[6] *2 East, Pleas of the Crown,* 555.

Robbery. At common law the offense of *robbery* is the forcible taking of money or goods from the person of another, or goods which are in his possession. Today, as in the case of larceny, all forms of personal property may be the subject matter of robbery. It is immaterial that the property has only slight value. Thus, old hand luggage, which has no market value but is being preserved by the owner, is the subject of larceny.[7] It is not necessary that the property be taken from the owner; hence the offense may be against the one who may have custody of the goods. The intent to steal is, as in the case of larceny, an element of the offense of robbery.

> When money was taken from a man in a parked automobile, it was not necessary to show that the property taken belonged to him, "it being sufficient if he had the exclusive possession or control over it." (Lanahan v. State, 176 Ark. 104, 2 S. W. [2d] 55)

Larceny from the person is similar to robbery in that the goods or money are taken from the person or in his presence, but it is different in that the former lacks the element of violence or putting into fear. Thus one court stated: "The secret and furtive taking of money from the person of another without his knowledge or consent, and the deceitful means and artful practices resorted to by swindlers to cheat and defraud others, are just the reverse of force and intimidation, which are an indispensable element of robbery." [8]

If personal violence is exercised, the degree of force employed is immaterial, except in some cases in which it is considered for the purpose of determining the punishment. Robbery by putting in fear consists of intimidation by threats of injury to person or property. Robbery is established, however, only when the violence or intimidation precedes or accompanies the taking of the property.

Embezzlement. The offense of *embezzlement* consists of the fraudulent misappropriation by a person of personal property which has been intrusted to him for care or disposition. This crime did not exist at common law; it is purely

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[7] *Jackson* v. *State*, 69 Ala. 249.

a statutory offense. "The statutes relating to embezzlement, both in this country and in England, had their origin in a design to supply a defect which was found to exist in the criminal law. By reason of nice and subtle distinctions, which courts of law had recognized and sanctioned, it was difficult to reach and punish the fraudulent taking and appropriation of money and chattels by persons exercising certain trades and occupations, by virtue of which they held a relation of confidence and trust towards their employers or principals, and thereby became possessed of their property. In such cases the moral guilt was the same as if the offender had been guilty of an actual felonious taking; but in many cases he could not be convicted of larceny, because the property which had been fraudulently converted was lawfully in his possession by virtue of his employment, and there was not that technical taking which is essential to the proof of the crime of larceny." [9]

> "One cannot steal or embezzle his own property so as to render himself criminally liable therefor." (State v. Carr, 169 Wash. 56, 13 P. [2d] 497)

The provisions of legislative enactments on the subject of embezzlement vary in details but are in general agreement as to their elements. First, the wrongdoer must have possession of the personal property, so that his taking does not constitute a trespass. Second, he must come into possession of the property by virtue of some trust or confidence, as when goods are entrusted to a servant for the master, when money is given to an agent for the principal, or when goods are transferred to a bailee in any form of bailment. Third, there must be a conversion of the property with fraudulent intent to deprive the owner of its use. For example, if a person who is intrusted with ten shares of stock sells or otherwise disposes of the stock as his own under the erroneous impression that it belongs to him, he is not guilty of embezzlement.[10]

Receiving Stolen Goods. The offense of receiving stolen goods consists, generally speaking, in knowingly buying or

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[9] *Commonwealth* v. *Hays*, 14 Gray (Mass.) 63.
[10] *Spaulding* v. *People*, 172 Ill. 40, 49 N. E. 993.

concealing goods previously stolen, or in aiding in their concealment with intent to deprive the owner of possession. This offense is a misdemeanor at common law. Today, under statutes in practically every state, it is a felony. The provisions of these statutes vary in details but not in fundamentals.

> To constitute the crime of receiving stolen goods, it is not necessary to show that the goods were received from the person who stole them. (Commonwealth v. Grossman, 261 Mass. 68, 158 N. E. 338)

There are, generally speaking, four elements of the offense in question. First, the goods must have been stolen by some other person. Second, the defendant must have purchased or received the goods for the purpose of concealing them or must have aided in concealing them. Third, the defendant must have known that the goods were stolen at the time he purchased or received them or aided in concealing them. It is not necessary, however, that the person have actual knowledge of the theft. Thus one court stated: "If all the facts and circumstances surrounding the receiving of the goods by defendant were such as would reasonably satisfy a man of defendant's age and intelligence that the goods were stolen, or if he failed to follow up such inquiry so suggested, for fear he would learn the truth and know that the goods were stolen, then the defendant should be rigidly held responsible as if he had actual knowledge." [11] Fourth, the defendant must have received the goods or aided in their concealment with intent to deprive the owner of them.

Malicious Mischief. In practically all states, statutes have been enacted declaring willful, injurious acts to the property of another to be a felony or a misdemeanor. The offense is known as *malicious mischief*. It consists, generally speaking, of the wanton, malicious, or reckless destruction of, or injury to, property belonging to another person. The crime is particularly reprehensible since the wrongdoer ordinarily acts either from wanton cruelty or for revenge and has no intent to gain from the loss suffered by the other.

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[11] *State* v. *Feuerbaken*, 96 Iowa 299, 65 N. W. 299.

A defendant, who felt that he had been dispossessed from certain land, was convicted of malicious mischief when he opened a fence and turned sixty-five head of horses in on the flax crop of one occupying the land. (State v. Spitzer, 55 N. D. 774, 215 N. W. 270)

The offense may be against the personal or real property of another, depending upon the wording of the statute. Generally speaking, it includes such acts as the malicious destruction of a horse, cow, sheep, or other animal belonging to another, by poison or other means; the malicious contamination of a stream or well which is being used; the malicious burning of a barn or furniture; the wanton injuring of trees and shrubbery; the malicious defacing of the walls of a building or a tomb; and the malicious cutting or tearing down of telegraph wires.[12]

Some statutes define the offense in terms of malice. An act is generally considered as being malicious under such legislation when it is willfully done without legal excuse or justification. Other statutes, in defining the crime, employ the terms *willful*, *wanton*, and *unlawful*. A wanton act means an act committed with indifference and disregard to the rights of other persons. A willful act is one done voluntarily and with a perversive spirit.

QUESTIONS

1. Kimberley secretes himself in Orrington's house for the purpose of stealing the silverware later during the night. While searching the premises, he is discovered and escapes by breaking a window at the rear of the house. Later Kimberley is arrested and charged with burglary. Is he guilty of this offense?

2. Dillingham plans to steal some oriental rugs from Kranz's home. He enters the house by merely raising an unlocked window, but he discovers that there are no rugs there. Dillingham is arrested and tried on a charge of burglary. His defense is that the property he intended to steal was not there. Is this a valid defense?

3. Royden lives in a suburban district near the tracks of a railroad which furnishes transportation to the city. One day a tramp who is walking along the tracks observes Royden's home and decides to steal

[12] *State* v. *Watt*, 48 Ark. 56, 2 S. W. 342.

anything of value in the house that night. About midnight the tramp enters the house by going down a large chimney, and he steals several valuable jewels. Is he guilty of burglary?

4. A thief, while mingling in a circus crowd, reaches into Kurzen's pocket and removes a watch. Just as he starts away, Kurzen grabs his wrist and holds him until the arrival of an officer. The thief is arrested and charged with larceny. At the trial it is proved that the watch was fastened by a chain to Kurzen's vest. Is the thief guilty of the charge?

5. One Sunday morning Langan finds the back door of a meat and grocery store open. He enters with the intent to steal and takes two hams from the refrigerator and places them near the door. As he returns for other goods, he is surprised and captured. Is Langan guilty of larceny?

6. Purvis attended an old settler's picnic. During the day a thief picked his pocket, taking from him a purse containing thirty-five dollars. Later the thief was arrested with the purse in his possession and was charged with robbery. Was he guilty of this offense?

7. Margolis receives a package at the office of an express company and starts home with it. On the way he meets Heims, who snatches the package out of his hand and flees. Margolis overtakes him and attempts to retake the package, but he is unable to do so because Heims forcibly resists him with a heavy walking stick. Heims is arrested later and charged with robbery. Is he guilty of this offense?

8. Randall is a collecting agent for a large electric power and light company. One day he receives an unusually large number of payments and uses the money for his own purposes. When the company discovers the shortage in Randall's account, it has him arrested and charged with larceny. Is Randall guilty of this offense?

9. Arnold is the owner of a large retail clothing store and employs Parker to act as clerk in the store. Parker sells a suit of clothes for which he receives sixty dollars in bills; he places the money in the cash register. Before any other money is placed in the cash register, Parker removes the bills he had placed there and hides them in the rear of the store with the intent of getting them at the closing hour. Arnold observes Parker's actions and has him arrested and charged with embezzlement. Is Parker guilty of this charge?

10. Mener steals an automobile in one state and drives it into another state. At a city where he spends the night, Mener places the car in a private garage where it is overlooked by the police who are making a search for it. The next morning Mener takes the car from the garage and escapes. The owner of the garage is arrested and tried on the charge of receiving stolen property. He proves at the trial that he had no knowledge of the fact or any reason to believe that the machine was stolen. Is this a valid defense?

Part IV—Crimes against Business Relations

Monopolies and Combinations. To protect the public from the evils arising from monopolies and combinations in restraint of trade, almost all the states have enacted antitrust statutes. These statutes vary in scope and details. Generally speaking, they are directed against unreasonable combinations and agreements which tend to stifle competition, to restrain trade, to control the production, supply, or prices of commodities, or to create or maintain a monopoly. The legislation in the various states is of the same general nature as the Federal Antitrust Act, known as the Sherman Act.[1]

> "What a person may lawfully do individually he may not always do lawfully by combination, or through co-operation with others." (Hill Bros. v. Federal Trade Commission, 9 F. [2d] 481)

The Federal act, although limited to commerce among the states and with foreign nations, is by far the most important antitrust legislation existing today. The provisions of this act are: First, "every contract, combination in the form of a trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations, is declared to be illegal." Every person who shall make any such contract or engage in any such combination or conspiracy, "shall be deemed guilty of a misdemeanor." Second, "every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor."[2] The punishment fixed for the violation of either of these provisions is a fine not exceeding five thousand dollars, or imprisonment not exceeding one year, or both.

The Federal act, although apparently applying to all combinations and contracts in restraint of trade, has been modified by the "rule of reason" doctrine. In construing this statute, the Supreme Court of the United States announced that its

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[1] This act has been amended by the Clayton Act, the Federal Trade Commission Act, the Shipping Act, and other legislation.

[2] *United States Code*, 1940, Title 15, ch. 1, §§1 and 2.

provisions do not apply to natural and reasonable combinations in restraint of trade. Thus, combinations made in good faith purely for the purpose of establishing economies of large-scale management are not illegal.[3]

> "In construing statutes and contracts against monopolies or in restraint of trade both state and federal courts in this country have applied the rule of reason rather than the literal import of the statute, and have said in substance that it must amount to an undue or unreasonable restraint of trade." (Lee v. Clearwater Growers' Assn., 93 Fla. 214, 111 S. 722)

Congress has expressly declared that combinations restricting competition in export trade with foreign countries are not illegal, unless such restraints or monopolies affect domestic commerce. This is known as the Webb Act.[4] Congress has also expressly declared that the antitrust law does not apply to farmers and dairymen who associate to market their products, but the Secretary of Agriculture may order such associations to cease restraining or monopolizing trade if they unduly enhance prices of agricultural products.[5]

Blacklisting. Many states have enacted statutes to protect employees from oppressive acts of employers. One statute reads: "Every person in this state who shall willfully and maliciously send or deliver, or make, or cause to be made, for the purpose of being delivered or sent, or part with the possession of any paper, letter or writing, with or without name signed thereto, or signed with a fictitious name, or with any letter, mark or other designation, or publish or cause to be published a statement for the purpose of preventing any other person from obtaining employment in this state or elsewhere, and every person who shall willfully and maliciously 'blacklist' or cause to be 'blacklisted' any person or persons, by writing, printing, or publishing, or causing the same to be done, the name, or mark, or designation representing the name of any person in any paper, pamphlet, circular or book,

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[3] *Standard Oil Company* v. *United States*, 221 U. S. 1, 55 L. Ed. 619.
[4] *United States Code*, 1940, Title 15, §62.
[5] *United States Code*, 1940, Title 7, §291.

together with any statement concerning persons named, or publish or cause to be published that any person is a member of any secret organization, for the purpose of preventing such person from securing employment, or who shall do any of the things mentioned in this section for the purpose of causing the discharge of any person employed by any railroad or other company, corporation, individual or individuals, shall, on conviction thereof, be adjudged guilty of a misdemeanor." [6] Other statutes merely prohibit a blacklist for the purpose of preventing a discharged employee from securing employment elsewhere. In some states blacklisting as an offense is considered under provisions pertaining to boycotts or restraint of trade.

> "An intent to injure by preventing future employment is the essence of the offense of blacklisting." (State v. Dabney [Okla. Cr.], 141 P. 303)

The offense is usually considered a misdemeanor, but the various statutes prescribe different penalties. To illustrate, in the statute just quoted, the penalty is a fine of not less than one hundred dollars or more than one thousand dollars, or imprisonment in the county jail for not less than ninety days or more than one year, or both. Another statute prescribes a punishment by a fine of not less than fifty dollars or more than two hundred and fifty dollars, or imprisonment in the county jail for not less than thirty days or more than ninety days, or both.[7]

Conspiracy. At common law the offense of conspiracy consists of a federation or combination of two or more persons to perform an unlawful act or a lawful act by unlawful means. It is therefore a criminal offense to combine corruptly for the purpose of committing felonies or misdemeanors, such as obtaining money by false pretenses, extortion, murder, or bribery. It is also criminal to federate for the purpose of injuring a person in his business relations. For example, it is an offense to combine for the purpose of ruining another in his business or profession by means such as causing a with-

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[6] *Remington's Revised Statutes of Washington*, 1932, §7599.
[7] *Oregon Compiled Laws*, 1940, Title 102, §807.

drawal of patronage or a boycott.[8] The crime of conspiracy is now governed by statutes which enlarge or modify the crime as it exists at common law.

> "Many men may be engaged in committing the same sort of crime, each knowing that the others are so engaged, without becoming conspirators." (United States v. Russell, 41 F. [2d] 852)

At common law it is not necessary that the purpose of the combination be completed to establish the crime of conspiracy. Indeed, it is not even necessary that there be an overt act in furtherance of the design. Thus, one court stated that "the gist of a conspiracy is the unlawful confederacy to do an unlawful act, or even a lawful act for unlawful purposes; that the offense is complete when the confederacy is made, and any act done in pursuance of it is not a constituent part of the offense, but merely an aggravation of it. This rule of common law is to prevent unlawful combinations. A solitary offender may be easily detected and punished; but combinations against the law are always dangerous to the public peace and to private security. To guard against the union of numbers to effect an unlawful design is not easy, and to detect and to punish them is often difficult. The unlawful confederacy is therefore punished, to prevent the doing of any act in execution of it." [9]

Libel. It has been previously noted that a person who falsely defames another without legal excuse or justification is liable in a civil action for damages.[10] The same act may also subject the person to criminal liability. *Libel* as a criminal offense is based upon its tendency to cause a breach of the peace. Under some statutes, however, the offense appears to be based upon the tendency to injure another rather than to cause a breach of the peace.

> "The gist of the crime is, not the injury to the reputation of the person libeled, but that the publication affects injuriously the peace and good order of society." (State v. Gardner, 112 Conn. 121, 151 A. 349)

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[8] *State* v. *Stewart*, 59 Vt. 273, 9 A. 559.
[9] *Commonwealth* v. *Judd*, 2 Mass. 337.
[10] *Ante*, p. 895.

Criminal libel at common law differs from civil libel in two elements. First, because the offense involves a breach of the peace, publication to third parties is not an essential element. Thus one court stated: "The basis of the [civil] action is damages for the injury to character in the opinion of others. This cannot arise but from publication. A criminal prosecution for sending a libelous letter is not founded on publication, but on the inducement which it produceth to a breach of the peace. The provocation is the same in the breast of the party libelled, whether the libel be or be not published to the world." [11] Second, truth is not a defense in a criminal action at common law, as the effect of the libel toward a breach of the peace is the same whether it is true or not. Under statutes in almost all the states truth is now a complete defense, particularly when it appears that the defamation was published under such circumstances as to justify the conclusion that it was made in good faith and for justifiable ends.

Affrays and Riots. At common law and under statutes a combat between two or more persons in a public place, causing the terror of others, is an offense known as an *affray*. The offense has been defined as "a disturbance of the public peace, by a fighting with the mutual consent of the combatants." [12]

> When the statute reads "If two persons voluntarily or by agreement fight," etc., an affray is not limited "to fighting by consent or agreement," as it is under some statutes. (State v. Renda, 125 Me. 451, 134 A. 571)

There are three essential elements of this offense. First, there must be a combat or fighting. For example, when two or more persons use threatening, abusive, or profane language to each other in a public place, there is no affray.[13] Second, there must be two or more persons engaged in the fighting. Third, the fighting must be in a public place, such as the street or a highway or a public building. The gist of the offense is the alarming of the people. Thus, in holding that

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[11] *Lyle* v. *Clason*, 1 Caines (N. Y.) 581.
[12] *Duncan* v. *Commonwealth*, 6 Dana (Ky.) 295.
[13] *Blackwell* v. *State*, 119 Ga. 314, 46 S. E. 432.

a fight, staged ninety feet from the street, constituted an affray, the court pointed out that the tumult could be heard, that the exciting scenes could be observed, and that the passing public could be injured by missiles, and stated: "What difference can it make, so far as terror to the public is concerned, whether the fight actually occurs in the street, or hard by it? The distinguishing element of terror to the people is as much present in the latter, as in the former case." [14]

An offense closely akin to an affray is a *riot.* This offense has been defined as "a tumultuous disturbance of the peace by three or more assembling together of their own authority with an intent mutually to assist one another against any one who shall oppose them in the execution of some enterprise of a private nature, and afterwards actually executing the same in a violent and turbulent manner to the terror of the people, whether the act intended was of itself lawful or unlawful." [15] At common law this offense differed from an affray in number and in that in case of an affray the meeting of the combatants might be accidental. The statutory definitions of a riot vary greatly, differing as to the necessity of force, as to the number required, and as to the purpose of the assembly.

QUESTIONS

1. Meagan, Klingman, and Comstock entered into an agreement to prevent Reeder from operating his coal mine. To carry out their purpose, they set fire to several sheds housing tools and appliances, and they destroyed the machinery for operating the fan. Reeder charged that they were guilty of a conspiracy to restrain and monopolize interstate commerce and brought an action for treble damages under the Federal Antitrust Act. Was he entitled to judgment?

2. About thirty-five master plumbers in the various states formed an organization known as the National Association of Plumbers. The purpose of the organization was to prevent manufacturers and dealers from selling directly to the consumer. To accomplish this, the members resolved to refuse to patronize any manufacturer or dealer who refused to deal exclusively with them. It was alleged that these persons were guilty, under the terms of the federal legislation, of combining to restrain trade and commerce. Do you agree?

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[14] *Carwile* v. *State,* 35 Ala. 392, 80 S. 937.
[15] *Adamson* v. *New York,* 188 N. Y. 255.

3. The manufacturers and wholesalers of a given product entered into an agreement concerning the marketing of their goods at a given price. The wholesalers furnished the manufacturers with a list of the dealers who sold this product at a cut-rate price. One of the dealers whose name appeared on the list contended that the wholesalers were guilty of blacklisting. Was this contention sound?

4. Matthews employed Hendriks to work in his foundry, but discharged him a few months later. Hendriks then sought employment from Childen. Childen wrote to Matthews about Hendriks' qualifications. Matthews replied, stating that the work of Hendriks, while in his organization, had not been satisfactory. Because of this statement, Childen refused to hire Hendriks who contended that he had been blacklisted. Was Matthews guilty of this offense?

5. Hurdler, McViner, and Elstrom entered into an agreement to destroy Pittenger's business. To carry this purpose into execution, they threatened his customers, had him arrested for violation of minor city ordinances, and circulated false reports about him. Pittenger had Hurdler, McViner, and Elstrom arrested and charged with conspiracy. Were they guilty of this offense?

6. Kinard and Seaton entered into an agreement to extort money from Zinser. Their plan was to induce Zinser, who was engaged in the drug business, to sell them more liquor than he was allowed to sell by law and then to compel him to pay them a given sum under the threat of prosecution. Before they could carry out their plan, Kinard and Seaton were arrested and charged with conspiracy. Could the state maintain this action?

7. An editor of a newspaper made an attack on the grand jury and the state's attorney. He printed in his newspaper the following statement: "It took them fifteen minutes to indict a friendless horse thief, a poor old woman, and a penniless forger. They spent three days on the Barnum case and then justified the murderous assault." He also stated that the state's attorney was "a most relentless prosecutor when a man drops a nickel in the slot machine or takes a drink on Sunday, or a poor fallen woman is caught sinning. Such heinous crimes must be punished. They are dangerous at once to life and limb. But any one can try to brain a man with an ax and secure immunity from the blindfolded representatives of justice." The editor was arrested and charged with libel. At the trial he offered to prove the truth of the statement as a defense. Was he entitled to do so?

8. Hughes and Otten are opponents in a gubernatorial contest. The former sends out a printed statement charging that the latter had misrepresented his age to avoid the draft during a given war. Hughes is arrested and charged with criminal libel. Is he guilty?

Part V—Crimes against Business Transactions

Forgery. At common law and under various statutes forgery consists of the fraudulent making or altering of an instrument, which apparently creates or changes a legal liability of another. Forgery has been defined in many ways by courts and statutes. One court states that it consists of "the false making of an instrument which purports to be that which it is not." [1] Another court defines the offense as "the false and fraudulent making or altering of an instrument which would, if genuine, apparently impose a legal liability on another or change his liability to his prejudice." [2]

Forgery may take one of many forms. It may consist of the making of an entire instrument or the alteration of an existing one. It may result from signing a fictitious name or the offender's own name when the act is done with the intent to defraud.

> "Under the forgery statutes of our state, only those instruments which are therein named can be made the subject of forgery." (State v. Brown, 175 La. 357, 143 S. 288)

In the absence of statute, it is usually held that there are three essential elements of the crime. First, there must be an instrument in writing which is apparently of some legal efficacy. The making or alteration of an instrument which is a mere nullity would not constitute forgery. Second, there must be an intent to defraud. If a person makes or changes an instrument by mistake or in good faith, he is not guilty of this offense. Third, there must be a false making or material alteration of the instrument. A material alteration exists when the legal effect of the instrument is changed or the status of the parties is changed.

Swindles and Confidence Games. The act of a person who, intending to cheat and defraud, obtains money or property by trick, deception, fraud, or other device, is an offense known as *swindle* or *confidence game.* The latter name is peculiarly appropriate because of the fact that the swindler frequently

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[1] *People* v. *Shanley,* 132 App. Div. 821, 117 N. Y. S. 845.
[2] *State* v. *Lotono,* 62 W. Va. 310, 58 S. E. 621.

makes possible or at least facilitates his scheme or design by first gaining the confidence of his victim.

> In the popularly known "empty grave case," the defendant was convicted of swindling by obtaining $5,000 from an insurance company by pretending to die and to be buried, and representing through his wife and agent that he was dead. (Cockran v. State, 93 Tex. Cr. 483, 248 S. W. 43)

False or bogus checks and spurious coins are frequently employed in swindling operations directed toward the man engaged in business. The practices and schemes, however, which are utilized for the purpose of trickery and deception are too numerous to mention. As one court stated: " 'Confidence game' can hardly be defined in a manner which would cover all cases, for the reason that schemes, the purpose of which is to swindle others, are, as has been frequently stated, 'As various as the mind of man is suggestive.' Generally speaking, it is a swindling operation by means of which advantage is taken of the confidence reposed by the victim in the swindler." [3] The operation of the particular scheme is immaterial, so long as its purpose is to work a cheat and a fraud.

Lotteries. Most states have enacted statutes prohibiting lotteries. Any scheme in which a person purchases an opportunity to win a prize which is to be awarded by drawing from a box, by wheel, or by other methods of chance is known as a *lottery.*

> A statute prohibiting lotteries and making possession of tickets, certificates, or orders used in the operation of a lottery prima facie evidence of a violation of such statute, was held to be not unconstitutional. (State v. Fowler, 205 N. C. 608, 172 S. E. 191)

There are three elements of this offense. First, there must be a payment of money or something of value for the opportunity to win. Second, there must be a distribution of prizes. Third, these prizes must be awarded by lot or chance. If these elements appear, it is immaterial that the transaction

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[3] *Elliot* v. *People*, 56 Colo. 236, 138 P. 39.

appears to be a legitimate form of business or that the transaction is called by some name other than a lottery. For example, if a person contracts to sell land tracts of different values to be conveyed to the purchasers by lot, the scheme is a lottery.[4] The same is true when prizes are distributed by chance to the purchasers of bonds. A lottery also exists when prizes are awarded by chance to persons purchasing subscriptions to newspapers. The methods of conducting lotteries in connection with otherwise legitimate transactions are too numerous to mention. It is sufficient to state that whenever the schemes involves the elements set out above, it is illegal where lotteries are forbidden.

Use of Mails to Promote Fraud. The mails are a necessity to modern business, but at the same time they afford a convenient means by which swindles can be accomplished. To prevent imposition on the public in this manner, Congress has enacted a statute prohibiting the use of the mails to further any scheme or artifice to defraud. The provisions of this statute are: "Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, . . . or by any scheme or artifice to obtain money by or through correspondence, by what is commonly called the 'sawdust swindle,' or 'counterfeit-money fraud,' or by dealing or pretending to deal in what is commonly called 'green articles,' 'green coin,' 'green goods,' 'bills,' 'paper goods,' 'spurious Treasury notes,' 'United States goods,' 'green cigars,' or any other names or terms intended to be understood as relating to such counterfeit or spurious articles, shall, for purpose of executing such scheme or artifice or attempting to do so, place or cause to be placed, in any depository of the mails, any letter . . . shall be fined not more than $1,000 or imprisoned not more than five years or both." [5]

> The purpose of the statute with respect to the use of the mails is "to prevent their use in aid of schemes and artifices having in view the defrauding of others of their money and property." (Horman v. United States, 116 F. 350)

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[4] *Lynch* v. *Rosenthal*, 144 Ind. 86, 42 N. E. 40.
[5] *United States Code*, 1940, Title 18, §338.

There are two elements of the offense. First, there must be a contemplated or organized scheme or artifice to defraud or to obtain money or property by false pretenses. Illustrations of schemes or artifices which come within the statute are false statements to secure credit, circulars announcing false cures for sale, false statements to sell stock in a corporation, and false statements as to the origin of a fire and the value of the destroyed goods for the purpose of securing indemnity from an insurance company.[6] Second, there must be a letter, writing, or pamphlet placed or caused to be placed in the mails for the purpose of executing or attempting to execute such scheme or artifice. One piece of material deposited in the mails is sufficient to constitute the offense.

False Weights, Measures, and Labels. Congress is given the power to "fix the standard of weights and measures."[7] Under this power Congress has prescribed the size of measures, such as barrels, baskets, and containers of fruits and vegetables. In some cases the containers are required to have their weight stamped upon them, as in the case of lime barrels.[8] Congress may also regulate weights, measures, and labels because of its power over interstate commerce. Under this power several important federal acts have been passed. First, Congress has enacted a law to stop the use of deceptive labels on both food and drugs by requiring that dangerous and harmful ingredients contained in food and drugs be marked on the label, and by prohibiting the use of fraudulent statements as to the curative effects of such articles. An amendment to the act, enacted later, requires that food and drugs must be conspicuously and clearly marked so as to indicate the quantity of the contents, particularly in respect to certain ingredients.[9] Second, Congress has prescribed that all meats prepared for interstate commerce must be examined by a federal inspector before and after slaughter, and that the containers of meats which have been approved must be labeled as passed. This legislation is known as the Meat Inspection Act.[10]

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[6] *Spirou* v. *United States*, 24 F. (2d ed.) 796.
[7] *United States Constitution*, Art. 1, §8.
[8] *United States Code*, 1940, Title 15, §§231-256.
[9] *Ibid.*, Title 21, ch. 1.
[10] *Ibid.*, Title 21, ch. 4.

> The manufacture for sale and the sale of two quart metal hampers does not violate the statute which does not prescribe standard capacities for containers less than four quarts. (United States v. Resnik, 299 U. S. 207, 81 L. Ed. 127)

The burden, however, of preventing fraud upon the public by the use of not only false weights and measures, but also false labels, falls, to a large extent, upon the states. Practically all the states have legislation for this purpose, although the statutes differ in detail and scope. The power to enact such regulations is frequently delegated to municipal governments.

In some states the statutes merely prohibit the use of false weights, measures, and labels. In other states the statutes prohibit the use of labels falsely indicating the weight, size, or contents of a container or of its ingredients. In other states the statutes or ordinances of the city prescribe the size, weight, or quantity of goods offered for sale. These statutes are usually held to be constitutional. Thus, when it was required that all bread be sold in loaves of one pound, two pounds, and four pounds (and no other) avoirdupois, and a punishment prescribed by a fine of fifty dollars or imprisonment for a month in case of a violation, the court, in sustaining the validity of the statute, said: "Our statutes not only fix the number of pounds of each of the various commodities that shall constitute a bushel, but they provide that a box or basket of peaches shall contain one-third bushel, and they fix the size of a barrel of fruit, roots, or vegetables, and they may, with equal propriety, fix the weight of a package or loaf of bread." [11] The statutes in the various states differ as to standards and penalties, and as to whether intent is a necessary element of the offense.

Obtaining Goods by False Pretenses. In almost all the states there are statutes of some nature directed against obtaining money or goods by means of false pretenses. These statutes vary in detail and scope. Some of them merely declare that one guilty of obtaining money or property by means

[11] *People* v. *Wagner*, 86 Mich. 594, 49 N. W. 609.

of false pretenses shall be punished by a specified penalty. Others set out the offense in more detail.

> "Whoever, by false pretenses and with intent to defraud, obtains anything of value or procures the signature of another as maker, indorser or guarantor of a bond, bill, receipt, promissory note, draft or check or other evidence of indebtedness, or whoever sells, barters or disposes of a bond, bill, receipt, promissory note, draft or check, or offers so to do, knowing the signature of the maker, indorser or guarantor thereof, to have been obtained by false pretense, if the value of the property or instrument so promised, sold, bartered or disposed of, is thirty-five dollars or more, shall be imprisoned in the penitentiary not less than one year nor more that three years, or, if less than that sum, shall be fined not less than ten dollars nor more than one hundred dollars or imprisoned not less than ten days nor more than sixty days, or both." (Throckmorton's Code of Ohio, 1929, Sec. 13104)

The important element of this offense is the intent to defraud. The early statutes in question did not apply to every false representation. Persons who were in the habit of giving credit could not use them to enforce collections by the terror of criminal prosecution. Courts held that these statutes did not apply to every false representation on the part of a merchant as to the cost, quality, salability, or value of the commodities which he sells, but that they were intended to protect persons from unusual artifices and ingeniously contrived frauds against which the common experience and ordinary sagacity of mankind would not afford a sufficient shield. Modern statutes, however, apply to all cases of misrepresentation of existing or past facts with the intent to obtain money or property from another.

False Coins and Currency. Congress is authorized by the Constitution of the United States "to coin money, and regulate the value thereof" and "to make all laws which shall be necessary and proper for carrying into execution" this power.[12] Pursuant to this power, Congress has enacted legislation to prevent the making, the possession with intent to pass, or the passing of counterfeit coins, bank notes, or obligations or

[12] Art. 1, §8 (5) and (16).

other securities of the United States. The phrase "obligations or other securities of the United States" is expressly declared to include national bank currency, coupons, United States notes, Treasury notes, gold certificates, silver certificates, fractional notes, bonds, certificates of deposit, bills, checks, or drafts for money, drawn by or upon an authorized officer of the United States. It also includes stamps and other representations of value of any denomination which has been or may be insured under any act of Congress. Legislation has also been enacted against the passing of counterfeit foreign securities or notes of foreign banks.

> "Obligations of the United States" include war savings certificates with stamps attached. (Rossi v. United States, 278 F. 349)

The penalties for passing or attempting to pass counterfeit coins, bills, or obligations or other securities of the United States vary, ranging from a fine of one thousand dollars and imprisonment for one year to a fine of five thousand dollars and imprisonment for fifteen years. For example, one provision states that "whoever shall buy, sell, exchange, transfer, receive, or deliver any false, forged, counterfeited, or altered obligation or other security of the United States, or circulating note of any banking association organized or acting under the laws thereof which has been or may hereafter be issued by virtue of any Act of Congress, with intent that the same be passed, published or used as true and genuine, shall be fined not more than five thousand dollars, or imprisoned not more than ten years, or both." [13]

The various states also have statutes preventing the making and passing of counterfeit coins and bank notes. These statutes often provide, as does the federal statute, a punishment for the mutilation of banknotes or the lightening or mutilation of coins.

Unfair Competition. An act of Congress expressly declares that "unfair methods of competition in commerce (inter-

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[13] *United States Code*, 1940, Title 18, ch. 7, §268.

state and foreign) are unlawful." [14] The act also establishes a Federal Trade Commission, consisting of five members, appointed by the President with the advice and consent of the Senate, who serve for a term of seven years.

> The object of the Federal Trade Commission Act "is to prevent public deception and to preserve free competition." (E. Griffiths Hughes, Inc. v. Federal Trade Commission, 63 F. [2d] 362)

The commission is empowered and directed to prevent persons, partnerships, and corporations, except banks and common carriers, from using unfair methods of competition in commerce. Under this power the commission has held that it is unfair to use certain schemes to obtain patronage, such as making gifts to employees for their influence, making gifts to customers, offering so-called "free" articles or services, offering benefits of memberships in a fictitious society or a fictitious membership in a given society, offering pretended guaranty, offering pretended "free trial" offers, offering pretended "valuable" premiums, making offers without intention to supply the goods, making fake demonstrations, securing signatures by trick, and lotteries.

> Any person who deems himself injured by unfair competition may request action by the Federal Trade Commission. (Federal Trade Commission v. Klesner, 280 U. S. 19, 74 L. Ed. 138)

The commission has also condemned the practice of using harassing tactics, such as coercion by refusing to sell, boycotting, discrimination, disparagement of a competitor or his products, enforcing payment wrongfully, cutting off or restricting the market, securing and using confidential information, spying on competitors, and inducing breach of customer contracts. Another form of unfair competition that has been condemned is misrepresentation by appropriating business or corporate names, simulating trade or corporate names, appropriating trade-marks, simulating the dress of a competitor's goods, simulating a competitor's advertising, using deceptive brands or labels, and using false and misleading advertising.

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[14] *United States Code*, 1940, Title 15, ch. 2, §45.

The Federal Trade Commission was justified in restraining false statements in magazine advertisements with respect to the qualities of certain salts as a fat reducer and remedy for obesity. (E. Griffiths Hughes, Inc. v. Federal Trade Commission, 77 F. [2d] 886)

When a given method is deemed to be unfair, the company is ordered to cease the practice. If it fails to do so, the commission seeks the aid of the circuit court of appeals. If the company feels the decision of the commission is unjust, it may appeal to the same court. In either case the court affirms, modifies, or reverses the decision.

The Federal Trade Commission is authorized to act only when public interest is involved. (Flynn & Emrick Co. v. Federal Trade Commission, 52 F. [2d] 836)

The commission is also empowered to investigate and require reports of corporations, to investigate the compliance of antitrust decrees, and the alleged violations of antitrust acts, and to assist in the readjustment of business corporations so that they may comply with the law. The commission is also authorized to investigate trade conditions in and with foreign countries.

QUESTIONS

1. Westfall, without authority, executes the following instrument:

July the tenth, 19—.

Sixty days from date I promise to pay
James McGarrity the sum of $500.00,

Five hundred and no/100.....Dollars

[Signed] ARTHUR DENBY
By his agent,
PERCIVAL WESTFALL.

It is contended that Westfall is guilty of forgery. Do you agree?

2. Hodgson, while digging in his garden, unearthed a sealed can. On opening the receptacle, he discovered some Confederate money which had been hidden there during the Civil War. He took part of this money and paid it as lawful money to Kernick, an ignorant man, in payment for two sacks of flour. Hodgson was arrested and brought

to trial for violating a statute which declares swindling illegal and punishable by a fine and imprisonment in the county jail. Can the state maintain this action?

3. Julian Trippe makes the following instrument:

COMMERCE BUSINESS BANK

August 31, 19—.

Pay to the order of *John Doe* $ *50.00*

Fifty and no/100 Dollars.

Julian Trippe.

Leander Jones adds another cipher to the fifty dollars written in the margin but leaves the body of the instrument reading fifty dollars as it was originally written. Later he is arrested and charged with forgery. Is he guilty of this offense?

4. Pierson is engaged in operating an amusement stand in connection with a carnival. He has knives and canes stuck in an incline floor which is located a short distance from a counter. He charges twenty-five cents for the privilege of throwing rings at the knives and canes and allows each person to have the cane or knife which he rings. It is contended that Pierson is engaged in a lottery. Do you agree?

5. A newspaper engaged in a scheme to increase its circulation. It announced that one thousand dollars would be given to the lucky person whose name was drawn by lot from a box. All persons, whether subscribers to the paper or not, were invited to write their names and addresses upon slips of paper and deposit them in a sealed receptacle. It was contended that the newspaper was engaged in a lottery. Was this contention sound?

6. Doran executes and delivers a promissory note for five hundred dollars, payable to Wiswall. On the date of maturity Doran is unable to pay the note. By falsely representing that several persons owe him money which will soon be collected, he induces Wiswall to extend the time for payment. When Wiswall discovers that Doran's statement as to outstanding debts due him was false, he has Doran arrested on the charge of obtaining money by false pretenses. Is Doran guilty of this offense?

7. Hambleton is arrested and charged with the violation of a state statute which prescribes that oleomargarine must be sold in packages having the name "Oleomargarine" clearly marked on them. At the trial Hambleton contends that this statute is unconstitutional. Do you agree?

8. Chase is engaged in a gambling game. After having lost all of his money, he puts a counterfeit ten-dollar bill up as his part of the stake. When the false money is discovered, Chase is arrested on

the charge of passing counterfeit money. Can this action be maintained against him?

9. The Universal Company sends out a catalogue in which it states that because of its large purchasing power and quick-moving stock it is able to sell sugar at a lower price than other similar firms. The attention of the Federal Trade Commission is called to this practice on the ground that it is unfair competition. Should the commission order the Universal Company to stop this method of advertising?

10. The Acme Company stops making an excellent brand of cream of tartar baking powder which it has widely advertised over a period of sixty years, and begins to manufacture a phosphate baking powder. The latter product is put up in a similar container and sold under practically the same trade name at about one half the former price. The attention of the Federal Trade Commission is called to this practice. Should the commission declare this method of competition unlawful?

CASES FOR REVIEW

1. Mrs. Lena Wunsch and her escort, Lautenschlager, left a garden in St. Louis, Missouri, at about 8:30 p. m. As they passed an alley, Albert Nerzinger threw sulphuric acid upon Mrs. Wunsch, entirely destroying her eyesight and severely burning her face and neck. What crime, if any, was Nerzinger guilty of committing? (State v. Nerzinger, 220 Mo. 36, 119 S. W. 379)

2. A check was drawn on the National Bank of the Republic, payable to Leo Lewinger. The body of the check ordered payment of "twenty-five hundred and no/100 ..... dollars." Stamped across the face and indented through the paper were the words and figures: "Not over $2500." When the instrument was presented for payment, the marginal figures, which had been only $25, read $2500, two ciphers having been added. Lewinger was charged with the crime of forgery. Was he guilty? (People v. Lewinger, 252 Ill. 332, 96 N. E. 837)

3. I. N. McBeth and others leased to Brooks & Company a building to be used for a meat shop. The company removed most of its goods before the end of the term. McBeth offered to refund part of the rent and requested possession. When possession was refused, McBeth forced open the back door by forcing the screws out of the socket holding the bolt. Thereafter he was prosecuted for violation of a statute that made liable one "who shall willfully, unlawfully, and maliciously break, destroy, or injure the door of any shop or building being the property of another." Was McBeth guilty? (State v. McBeth, 49 Kans. 584, 31 P. 145)

4. John Crawford was charged with burglary. The evidence tended to show that Crawford in the nighttime had bored three holes with a two-inch auger through the walls of a granary and into a mass of wheat stored therein, and that several bushels of wheat which passed out the aperture were taken away and sold by Crawford. The trial court directed the jury to acquit the defendant. Was the ruling of the court correct? (State v. Crawford, 8 N. D. 539, 80 N. W. 193)

5. A cow belonging to Dewey strayed onto the premises of Edward Muzzy. The animal was killed by Muzzy and his nephew, Leon. Thereafter Muzzy was convicted of maliciously killing the animal of another. The offense was punishable by imprisonment in the state's prison. Was Muzzy guilty of committing a felony or a misdemeanor? (State v. Muzzy, 87 Vt. 267, 88 A. 895)

6. Hadley Y. Brooke was the publisher of a newspaper in Crenshaw County, Alabama. He published alleged defamatory matter concerning Clifford K. Sharp, the county superintendent of education. Brooke, when prosecuted for criminal libel, pleaded truth among other things as a defense. Was his defense valid under the common law? (Brooke v. State, 154 Ala. 53, 45 S. 622)

7. William G. Taylor, a convict in the state prison at Auburn, New York, killed Solomon Johnson, a fellow convict. When he was tried for the crime of murder, it was contended as a defense that Taylor had acted under an insane delusion that Johnson had divulged his plan of escape to the prison authorities. Assuming the allegation to be true, did it constitute a valid defense? (People v. Taylor, 138 N. Y. 398, 34 N. E. 275)

8. Frank O. Moren, a tailor in Minneapolis, Minnesota, formed clubs of forty persons, each of whom paid a small weekly sum toward a $40 suit of clothes. Each week a drawing by lot was held, and the person obtaining the winning number received a suit without making further payments. When a member finally paid in the sum of $40, he received a suit. Moren was prosecuted for violating a statute against lotteries. Was he guilty? (State v. Moren, 48 Minn. 555, 51 N. W. 618)

9. William Douglass was prosecuted as an accomplice in connection with a crime involving the placing of an obstruction on a certain railroad track. The court charged the jury in effect that if the obstruction was placed upon the railroad track by some person other than the defendant and if the defendant was present and consented to the same, or if the defendant was present or absent and the same was done with the consent of the defendant, the defendant should be found guilty. Was the charge correct for the prosecution of Douglass either as a principal in the second degree or as an accessory before the fact? (State v. Douglass, 44 Kans. 618, 26 P. 476)

10. G. V. Janes was brought before S. H. Cooper, a justice of the peace, under arrest upon a warrant charging him with assault and

battery. Subsequently Cooper was charged in an indictment with having demanded and received from Janes the sum of 50¢ as a fee for taking an appearance bond before the fee was due. Cooper was guilty of what crime, if any? (State v. Cooper, 120 Tenn. 549, 113 S. W. 1048)

11. P. W. Fort was convicted of unlawfully selling intoxicating liquors known as "Fort's Tonics" in violation of the state liquor laws. In addition to a fine, his license to practice medicine in the state was revoked. Fort appealed from that part of the judgment revoking his license, and a question arose as to whether the crime for which he was convicted was a crime malum in se or a crime malum prohibitum. What is your opinion? (Fort v. City of Brinkley, 87 Ark. 400, 112 S. W. 1084)

12. Michael McDonald was convicted of kidnapping Patrick Towey and was confined in the state prison. He later sought his freedom on the ground of error in the proceedings. In reviewing the proceedings, the question arose as to whether secrecy was an element of the crime of kidnapping at common law. What is your opinion? (Ex parte McDonald, 50 Mont. 348, 146 P. 942)

13. John Radford unlawfully seized and carried Harvey Hudson, a boy about the age of eleven years, into the water of the Smoky Hill River in Saline County, Kansas. Hudson, against his will and over his protests, was taken where the water was of great depth and was drowned. What crime, if any, did Radford commit? (State v. Radford, 56 Kans. 591, 44 P. 19)

14. With the intent to steal, Will Clark took a cloak from the figure of a woman used for display purposes, rolled it up, and laid it upon the floor a short distance away. He was trying to take off the dress at the time he was arrested by an officer. The dress had been pulled down to the bottom of the figure, but was not, and could not be, removed in that manner. Clark was charged with larceny of the cloak and of the dress. Was he guilty? (Clark v. State, 59 Tex. Cr. 246, 128 S. W. 131)

15. Berry Moore was charged with the crime of arson. The alleged offense was in connection with a building belonging to J. E. Tomlinson. Moore contended that the building was merely scorched and smoked, and that no part of the building was charred. If the contention proved to be true, did he have a valid defense? (Moore v. State, 51 Tex. Cr. 468, 103 S. W. 188)

16. C. L. St. John was employed by Brink's, Incorporated, to call and receive packages containing currency and to transport such packages to the First National Bank of Birmingham, Alabama. One day the manager of the Atlantic & Pacific Tea Company, under a contract with Brink's, gave St. John a package containing the sum of $100. St. John extracted a $10 bill from the package before delivering the package to the bank. What crime, if any, did St. John commit? (St. John v. State, 27 Ala. A. 97, 168 S. 190)

CHAPTER XVIII

BANKRUPT AND CREDITORS

Part I—General Considerations

Introduction. One of the serious problems that constantly disturb the business world as well as society in general is the inability of persons or groups of persons to pay their debts. This type of problem is in part the result of human frailty in undertaking more than can be performed, and in part the consequence of modern marketing systems that encourage overbuying by the consumers of goods. In the business world, however, this kind of problem arises often from other causes, such as mistakes in judgment, business recessions, severe competition, and losses due to unavoidable risks of one type of peril or another.

Society is interested in the insolvency of a person, not only from the point of view of the creditors and from the point of view of the debtor, but also from the point of view of the members of society in general; consequently there have long been laws enacted to govern the relation of the insolvent person and his creditors. Federal statutes of this kind are known as bankruptcy laws, whereas similar statutes in the different states are called insolvency laws.

Definitions. The status of a person (or of a business association) who has been made subject to a bankrupt or bankruptcy statute is described as *bankruptcy*. This term is, however, also used with other meanings. A statutory system by which a person (or an association of persons) is declared to be a bankrupt and by which his estate is administered for the benefit of his creditors is known as a *bankruptcy* law. A person (or an association of persons) who is, voluntarily or involuntarily, made subject to a bankruptcy law or who has been declared to be a bankrupt is described as a *bankrupt*. An *adjudication in bankruptcy* is the decree that the debtor is declared to be a bankrupt. It is effective from its date or, in the event of an appeal, from the date when the decree is confirmed.

Federal Bankruptcy Act. Congress is authorized by the Constitution of the United States to enact "uniform laws on the subject of bankruptcies throughout the United States." [1] This authority was granted to the Federal Government by the framers of the Constitution "to enable Congress to prevent the enforcement of as many different bankrupt laws as there were states." [2]

Pursuant to its constitutional power Congress has enacted four bankruptcy laws. The first statute was enacted in 1800 and repealed in 1803; the second was enacted in 1841 and repealed in 1843; the third was enacted in 1867 and repealed in 1878; and the fourth was enacted in 1898. The last statute was extensively amended by a statute in 1938.[3]

The different states have power to enact laws in the nature of bankruptcy laws, known as insolvency laws. Such statutes are, however, subordinate to the Federal Bankruptcy Act. "The Constitution of the United States authorizes Congress . . . to enact bankruptcy legislation, and when such action is taken it is the supreme law of the land on the subject." [4]

Classification of Bankrupts. Bankrupts are divided into two classes. They are known as voluntary bankrupts and involuntary bankrupts.

Voluntary Bankrupts. A voluntary bankrupt is one who subjects himself to the bankruptcy law when he is under no duty to do so and cannot be compelled to do so. Generally speaking, any person may become a voluntary bankrupt. There are, however, a few associations of persons who may not do so. The terms of the Bankruptcy Act specifically exempt municipal, railroad, insurance, and banking corporations or building and loan associations from the benefits of the statute as a voluntary bankrupt.[5]

Involuntary Bankrupts. An involuntary bankrupt is one who has been subjected to the bankruptcy law by the action

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[1] Art. 1, §8, cl. 4.
[2] *Lea* v. *George M. West Co.*, 91 F. 237.
[3] *Public Laws, 1938*, Ch. 575.
[4] *Leidigh Carriage Co.* v. *Stengel*, 95 F. 637.
[5] *United States Code*, Title 11, §22-(a).

of his creditors. Under the prescribed circumstances,[6] most natural persons, partnerships, and corporations owing debts that amount to the sum of $1,000 may be forced by creditors into bankruptcy. There are, however, a few exceptions to this general statement. The terms of the Bankruptcy Act expressly exclude a wage earner, a person engaged chiefly in farming or tilling the soil, and municipal, railroad, insurance, and banking corporations or building and loan associations from being forced by creditors into bankruptcy.[7] In this connection, a wage earner is defined as an individual who works for wages, salary, or hire, and whose compensation therefor does not exceed the sum of $1,500 a year.[8]

Courts of Bankruptcy. The Bankruptcy Act specifically declares that certain courts shall be courts of bankruptcy, and it enumerates the powers of such courts.[9] These courts are "the district courts of the United States and of the Territories and possessions," and "the District Court of the United States for the District of Columbia." [10]

Courts of bankruptcy are empowered to declare to be bankrupts persons who have had their principal place of business, have resided, or have had their domicile for a greater part of the preceding six months within the territorial jurisdictions of the respective courts. A person may have his residence or his domicile within the territorial jurisdiction of one court and his principal place of business within the territorial jurisdiction of another court of bankruptcy. As a result, bankruptcy proceedings may be started properly by the creditors of the same debtor in more than one court of bankruptcy. In such cases, all proceedings will be consolidated in the court that is able to handle the administration of the estate with the greatest convenience to all the interested parties.[11]

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[6] *Post*, pp. 958 to 960.
[7] *United States Code*, Title 11, §22-(b).
[8] *Ibid.*, §1-(32).
[9] *Ibid.*, §11.
[10] *Ibid.*, §1-(10).
[11] *Ibid.*, §55.

QUESTIONS

1. It is said that "society is interested from three points of view in the problem presented by the insolvency of a person." What is meant by this statement?

2. How many bankruptcy acts have been enacted by Congress? By what authority has the Federal Government undertaken such legislation?

3. A certain state enacted an insolvency law. Thereafter it was contended that the provisions of this statute prevailed over the terms of the Federal Bankruptcy Act. Do you agree?

4. Ragle was helplessly in debt. Through the action of his creditors, he was subjected to the bankruptcy law. Was Ragle classified as a voluntary bankrupt?

5. A certain railroad corporation was in unusually difficult financial circumstances. As a result, its officers decided that the corporation should subject itself to the bankruptcy law. Was the corporation entitled to do this?

6. Heber owed the sum of $300 to Groeten; the sum of $167.40 to Williams; and the sum of $483 to Cantwell. When the debts were due and unpaid, the creditors sought to subject Heber to the bankruptcy law. Were they entitled to do so?

7. Shelton, who was engaged in general farming, owed in the aggregate the sum of $1,400 to several creditors. When the debts were due and unpaid, the creditors got together and decided tc subject Shelton to the bankruptcy law. Were they entitled to do so?

8. Addington, who was employed at a salary of $100 a month, purchased an automobile and new furniture for his home. As a result he was indebted to three creditors to the extent of the sum of $1,274.95. Thereafter, upon Addington's failure to pay his obligations, the creditors determined to subject him to the bankruptcy law. Were they entitled to do so?

9. Bankruptcy proceedings were instituted by a creditor against Wilson in a United States circuit court of appeals. It was contended by Wilson that the court did not have jurisdiction. Was this contention sound?

10. Bankruptcy proceedings were instituted by a creditor against Trolle in a United States district court. At the same time, certain creditors of Trolle filed a petition in another court of bankruptcy. It was contended that one of the two proceedings must necessarily have been improperly started. Do you agree with this contention?

Part II—Involuntary Proceedings

Who May Petition. The Bankruptcy Act expressly stipulates the number of creditors, the nature of their claims, and the amount of such debts that are required in order to file a petition in bankruptcy proceedings against a debtor.[1] If there are twelve or more creditors, then it is necessary for three or more creditors to join in the petition. If there are less than twelve creditors, it is permissible for one alone to file the petition.

> "Apparently it was recognized that creditors, for reasons of their own—tolerance, business judgment, friendship, or an avoidance of certain set-offs—might prefer to refrain from availing of the bankruptcy statute, and, therefore, where the creditors were more than 12 in number, a minimum of 3 petitioners was required." (In re Kehoe, 233 F. 415)

The petitioning creditors must have provable claims[2] against the debtor that amount in the aggregate to the sum of $500 or more. In case one creditor files the petition, he must have a provable claim amounting to such sum or more. It should be noted in this connection that the amount of the claims or claim must be in excess of the value of securities, if any, held by the creditors or creditor.

> A secured creditor may be a petitioning creditor for the amount of his claim in excess of the securities held. (East Tennessee Nat. Bank of Knoxville v. Day, 5 F. Supp. 473)

The debtor against whom the petition is filed may appear and oppose the petition.[3] If, for example, the debtor should allege that there were more than eleven creditors when the petition was filed by one creditor alone, and his allegation proved to be true, the petition would be dismissed. Creditors other than the original petitioners are also entitled to appear and oppose the petition.[4]

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[1] *United States Code*, Title 11, §95-(b).
[2] *Post*, p. 968.
[3] *United States Code*, Title 11, §41-(b).
[4] *Ibid.*, §95-(d).

When Petition May Be Filed. Creditors may not force a debtor into bankruptcy merely because they have sufficient unsecured provable claims. It is necessary that the debtor commit an act of bankruptcy within a period of four months prior to the filing of the petition.[5] In other words, the debtor must not only do that which is declared to be an act of bankruptcy, but he must do such an act within the prescribed period prior to the filing of the petition by the creditors.[6]

The Bankruptcy Act expressly provides that a debtor may commit an act of bankruptcy in any of the following ways:[7]

(1) By conveying, transferring, concealing, or removing, or permitting to be concealed or removed, any part of his property with intent to hinder, delay, or defraud his creditors, or any of them.

(2) By transferring, while insolvent, any portion of his property to one or more of his creditors with intent to prefer such creditor or creditors to his other creditors.

(3) By suffering, or permitting, while insolvent, any creditor to obtain a lien upon any of his property through legal proceedings and not having vacated or discharged such lien within thirty days from date thereof or at least five days before the date set for any sale or other disposition of such property.

(4) By making a general assignment for the benefit of his creditors.

(5) While insolvent, by being forced to put a receiver or a trustee in charge of his property.

(6) By admitting in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.

It should be noted that insolvency is an element of some of the acts of bankruptcy, whereas it is not an element of others. The Bankruptcy Act declares that a person is deemed to be insolvent under the provisions of the statute "whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, or removed, permitted to be concealed or removed, with intent to defraud,

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[5] *Ibid.*, §21-(b).
[6] *In re Louisell Lumber Co.*, 209 F. 784.
[7] *United States Code*, Title 11, §21-(a).

hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts." [8]

Receivers. Upon the filing of a petition in bankruptcy, the creditors may have reason to suspect that the debtor's property may be dissipated in some manner so that it will not be available for the payment of the debtor's obligations. In such a case, creditors having provable claims that may be affected by a discharge in bankruptcy are entitled to apply to the court for an appointment of a receiver. Such an appointment is, however, expressly confined by a provision of the statute to situations in which "the court shall be satisfied that such appointment or authorization is necessary to preserve the estate or to prevent loss thereto." [9]

> "A receiver's duties are limited by the powers given him in the order of appointment." (In re Metropolitan Motor Car Co., 225 F. 274)

A receiver is merely the custodian of the property of the alleged bankrupt and does not succeed to the title to such property. "A sufficient reason for the limited power and authority in such a temporary officer is that prior to and pending an adjudication in bankruptcy the property belongs to the bankrupt, and to him alone, and therefore the court can and should do no more than protect the property from dissipation and loss until it is ascertained that there is really a bankrupt estate to be administered upon." [10]

The authority of a receiver continues ordinarily only until the petition is dismissed or until a trustee has been appointed and has qualified for office. Upon the qualification of a trustee, it is the duty of the receiver to turn over to the trustee all property and money in his hands, minus such an amount as is necessary to pay the costs of the receivership.

Trustees. The office of trustee is specifically created by the provisions of the Bankruptcy Act.[11] One trustee or three trustees are appointed, usually by the creditors of the bank-

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[8] *Ibid.*, §1-(19).
[9] *Ibid.*, §11-(3).
[10] *In re Leonard*, 177 F. 506.
[11] *United States Code*, Title 11, §61.

rupt at their first meeting. If the creditors do not do so, the court makes the appointment or appointments. A trustee may be either a competent individual or a corporation authorized by its charter or by law to act in such a capacity.[12]

> An alien is not by that fact alone disqualified from acting as a trustee in bankruptcy. (In re Coe, 154 F. 162)

As previously indicated, the bankrupt is not deprived of his property by the appointment of a receiver; he is, however, by the appointment of one or more trustees. The property of the debtor, except that which is exempt, passes by operation of law to the trustee or trustees upon his or their appointment and qualification for office.[13] In this connection, trustees are authorized to avoid certain preferences gained by a judgment against the bankrupt or by a transfer of property, of which recording or registering is required, within four months prior to the filing of the petition or after the filing thereof and before adjudication.[14] They are required by the terms of the Bankruptcy Act to recover for the benefit of the creditors any of the bankrupt's property that has been transferred within four months prior to the filing of the petition, with the intent to hinder, delay, or defraud any creditors, or that is in the hands of a person under a transfer which is void by the laws of any state.[15]

> "The trustee takes such property not as an innocent purchaser, but subject to all valid claims, liens and equities enforceable against the bankrupt, except in cases where there has been a conveyance or encumbrance which is void or voidable as to the trustee by some positive provision of the bankruptcy act." (In re Toms, 101 F. [2d] 617)

Trustees in bankruptcy have certain duties that are prescribed by the terms of the Bankruptcy Act.[16] They must collect and reduce to money the property of the estate and deposit all money in one of the designated depositories. Regular accounts must be kept, showing the amount and the source of money received and the amount and the purpose

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[12] *Ibid.*, §73.
[13] *Ibid.*, §110-(a).
[14] *Ibid.*, §96-(b).
[15] *Ibid.*, §107-(d).
[16] *Ibid.*, §75-(a).

of all expenditures. Disbursements may be made only by check or draft. The trustees must furnish all information concerning the estate that may be demanded by interested parties. They must pay dividends to creditors within ten days after such sums have been declared by the referees. A report of their administration must be made at the final meeting of the creditors and within fifteen days thereafter to the court of bankruptcy.

Referees. The office of referee is specifically created by the terms of the Bankruptcy Act.[17] Courts of bankruptcy are authorized to appoint referees for a term of two years. There may be as many referees as are necessary in expeditiously transacting the bankruptcy business that may come before the courts.[18] The Bankruptcy Act expressly stipulates that referees may be removed by the courts, in their discretion, because the referee's services are not needed or for other cause.[19]

> The 1938 amendment places a restriction upon the number of referees by providing that "in so far as possible, the number shall be limited with a view to employment of referees on a full-time basis." (11 United States Code Annotated, Historical note, p. 207)

The qualifications of a referee are that he must reside and have an office within the district for which he is appointed, that he must be competent to perform the duties of the office, and that he must be a member in good standing at the bar of the district court of the United States in which he is appointed. The Bankruptcy Act specifically prohibits the appointment of an individual who is a relative of any judge of a court of bankruptcy or of any judge in an appellate court of the district where appointed, or who is the holder of a Federal or a state office for profit, except commissioners of deeds, justices of the peace, masters in chancery, and notaries public.[20] Other limitations in respect to referees are that they may not act in cases in which they are interested, that they

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[17] *Ibid.*, §61.
[18] *Ibid.*, §65.
[19] *Ibid.*, §62.
[20] *Ibid.*, §63.

may not practice as attorneys or counselors at law in any bankruptcy case, and that they may not be the purchaser, directly or indirectly, of any property of an estate in bankruptcy.[21]

> A person is not disqualified by interest from acting in a particular case merely because he owes a debt to the bankrupt. (Bray v. Cobb, 91 F. 102)

The duties of referees are set forth in the provisions of the Bankruptcy Act.[22] Dividends are declared by the referees, who provide the trustees with dividend sheets showing the amount of the dividends and to whom such dividends are payable. The referees examine the schedule of property and the list of creditors that have been filed by bankrupts, and they cause incomplete or defective schedules or lists to be amended. They must furnish information concerning the estate of a bankrupt that may be requested by interested parties. Referees are required also to keep records, to give notices to creditors, and to preserve evidence when such is necessary.

QUESTIONS

1. Ellison owed in the aggregate to eleven creditors the sum of $2,092.65. One of his creditors, to whom he owed the sum of $485, filed a petition to have Ellison adjudged a bankrupt. Was the creditor entitled to do this?

2. Fifteen creditors had claims against Faren amounting in the aggregate to the sum of $6,137. Three of the creditors, to each of whom Faren owed the sum of $350, filed a petition to have Faren adjudged a bankrupt. Some of the other creditors of Faren intervened for the purpose of opposing the petition. Were these other creditors entitled to intervene?

3. Carey, although not insolvent, concealed part of his property with the intent to hinder and delay three of his creditors. Thereafter these creditors filed a petition to have Carey adjudged bankrupt. Other creditors contended that Carey had not committed an act of bankruptcy. Do you agree?

4. Finney, although not insolvent, permitted a creditor to obtain through a legal proceedings a lien on his property. The lien was not

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[21] *Ibid.*, §67-(b).
[22] *Ibid*, §67-(a).

discharged by Finney within thirty days from the date the lien was obtained. Other creditors of Finney filed a petition to have him adjudged a bankrupt. It was contended by Finney that he had not committed an act of bankruptcy. Was his contention sound?

5. Ralston became insolvent, and a receiver was appointed and placed in charge of his estate. Thereupon three of his creditors, to whom he owed $11,000, joined in filing a petition to have Ralston adjudged a bankrupt. Were they entitled to do so?

6. Creditors of Blackman sought to subject him to the bankruptcy law. They contended that he had committed an act of bankruptcy of which insolvency was an element. It was alleged that Blackman had removed part of his property with the intent to delay his creditors. If the allegation proved to be true, was the contention of the creditors sound?

7. Upon filing a petition in bankruptcy against Thistle, the creditors demanded the appointment of a receiver by the court. The creditors contended that the court was required by the terms of the Bankruptcy Act to appoint a receiver to preserve the estate of a debtor upon the filing of a petition in bankruptcy. Do you agree?

8. A receiver was appointed by a court of bankruptcy to preserve the estate of a bankrupt. Thereafter a trustee was appointed. It was contended that the receiver was under a duty to transfer the title to the property in his hands to the trustee. Was this contention sound?

9. Creditors of a bankrupt failed to appoint a trustee at their first meeting. Thereupon the court of bankruptcy appointed a corporation to the office of trustee. It was contended that the appointment was invalid. Do you agree with this contention?

10. A referee declared a dividend for distribution among the creditors of a bankrupt. Eight days thereafter, one of the creditors contended that the trustee had failed to perform his duty because no payment of the declared dividend had been made. Do you agree with this contention?

11. A court of bankruptcy appointed Harris to act as a referee for a period of two years. Thirteen months thereafter, the court, believing that the services of Harris were no longer necessary, removed Harris from office. Harris, claiming that his removal was wrongful, sought to prove that his services were in fact necessary. Was he entitled to do so?

12. Gilder was a notary public. He was appointed by a court of bankruptcy to serve as a referee. It was thereafter contended that the appointment of Gilder was not valid. Do you agree with this contention?

Part III—Administration of Estates

Meetings of Creditors. Creditors are given by express terms of the Bankruptcy Act an opportunity to participate actively in the administration of the estate of a bankrupt.[1] The court is required to cause the first meeting of the creditors of a bankrupt to be held not less than ten nor more than thirty days after the adjudication of bankruptcy. The place of the meeting is ordinarily the county seat of the county in which the bankrupt had his principal place of business, resided, or had his domicile. If, however, such a place is clearly inconvenient for the parties in interest or if the bankrupt does not do business, reside, or have his domicile within the United States, the court fixes a place of meeting that is most convenient for the parties in interest. When by mischance the meeting of the creditors is not held within the specified time, the court fixes another date, as soon as may be thereafter, for the meeting.

The judge or referee presides over the first meeting of the creditors of a bankrupt. Before proceeding with other business, he may allow or disallow any claims of creditors that are there presented. He may also publicly examine the bankrupt or cause him to be examined at the request of any creditor.[2]

> "The purpose of an examination of the bankrupt under this statute is to assist in the administration of the bankrupt's property." (In re C. G. Grove & Son, 7 F. [2d] 228)

Subsequent meetings may be held at any time and place when all creditors who have obtained an allowance of their claims sign a written consent to such a meeting. Under some circumstances the court is required to call subsequent meetings upon the written request of less than all the creditors who have proven their claims. The court is also required to call a meeting of creditors whenever the affairs of the estate of the bankrupt are ready to be closed.[3]

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[1] *United States Code*, Title 11, §91-(a).
[2] *Ibid.*, §91-(b).
[3] *Ibid.*, §91-(d)-(e).

Creditors are entitled to ten days' notice by mail of all meetings of creditors.[4] At each meeting the creditors are allowed to take the steps necessary for the promotion of the best interests of the estate and the enforcement of the act.[5] They must pass upon all matters submitted to them at their meetings by a majority in numbers and in the amount of claims of all creditors whose claims have been allowed. Creditors who have priority or security are not entitled to vote, nor are their claims counted in computing the number of creditors or the amounts of their claims, unless the amount of their claims exceed the values of such priorities or securities, and then only for such excess.[6]

Examination of Bankrupt and Others. In order to enforce the Bankruptcy Act, the bankrupt may be examined concerning his acts, his conduct, or his property.[7] The Bankruptcy Act stipulates, however, that, except for the first meeting and for the hearing upon objections to his discharge, he must be paid for necessary traveling expenses for any distance in excess of one hundred miles from his home.[8]

If, during one month after the filing of the petition, there is satisfactory evidence by affidavit that the bankrupt is about to leave the district in which he resides or has his principal place of business to avoid an examination, and his departure will defeat the proceedings in bankruptcy, the bankrupt may be summoned before the court. If the allegations prove to be true, the court may place the bankrupt in the custody of the marshal for not more than ten days, until the bankrupt is examined and released or until he gives bail for appearances for examination during such ten days.[9]

> The statute does not authorize a bankruptcy court to order the arrest of an officer of the bankrupt corporation for examination. (Ginsberg & Sons v. Popkin, 285 U. S. 204, 76 L. Ed. 704)

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[4] *Ibid.*, §94-(a)-(3).
[5] *Ibid.*, §91-(c).
[6] *Ibid.*, §92-(a)-(b).
[7] *Ibid.*, §44-(a).
[8] *Ibid.*, §25-(a).
[9] *Ibid.*, §28-(a).

Other persons, including the wife of the bankrupt, upon the application of any officer, the bankrupt, or a creditor, may be required by the court to be examined concerning the acts, the conduct, or the property of the bankrupt whose estate is in the process of administration. The Bankruptcy Act expressly provides, however, that the wife of the bankrupt may be examined only in respect to business transacted by her or to which she is a party, and to determine the fact whether she has transacted or has been a party to any business of her husband.[10] A person may not be required to attend as a witness before a referee unless his mileage and a fee for one day's attendance is paid or tendered to him, and even if the mileage and the fee are tendered or paid, he may not be required to attend at a place more than one hundred miles from his residence.[11] In the event that attendance of a witness may not be compelled, his evidence may be obtained by deposition.[12]

Sale of Bankrupt's Estate. The sale of the estate of a bankrupt, with certain exemptions,[13] at the instigation of a court of bankruptcy is expressly provided for by the terms of the Bankruptcy Act.[14] The estate of the bankrupt consists of all his rights and interests in particular things, regardless of the nature and the extent of such rights and interests. It should be noted in this connection, however, that the officer who makes the sale does not warrant the extent of a bankrupt's right or interest in the thing sold.

Sales of a bankrupt's rights and interests are often made by the trustee, but it is not required that this procedure be followed. Other officers may be appointed by the court of bankruptcy, or auctioneers may be employed, to make the sales. Sales of the property at auction are not required. The property of the bankrupt may be sold at a private sale as well as at a public sale, in the absence of a valid objection to such procedure. Particular property may be sold subject to encumbrances or free from encumbrances. In the latter case, lienholders must be served with notice in order that the property may pass free from liens or other encumbrances.

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[10] *Ibid.*, §44-(a).
[11] *Ibid.*, §69-(a).
[12] *Ibid.*, §44-(b).
[13] *Post*, p. 974.
[14] *United States Code*, Title 11, §11-(7).

> A sale of a bankrupt's property free of liens "should not be ordered unless the court is satisfied that the interest of the general creditors would be advanced, and that the interest of the lien creditors would not be injuriously affected." (In re Styer, 98 F. 290)

Under the terms of the Bankruptcy Act, all sales of real and personal property of the bankrupt must, when practicable, be sold subject to the approval of the court of bankruptcy. In case of a sale of any property for less than seventy-five per cent of its value, confirmation by the court is absolutely necessary for validity. The value of the property is determined by one or more disinterested appraisers who are appointed by, and report to, the court of bankruptcy.[15]

Provable Claims of Creditors. The claims of creditors that may be proved and allowed against the estate of a bankrupt are expressly stated in the provisions of the Bankruptcy Act. These claims may be debts consisting of fixed claims or of unliquidated claims.

> "It is fundamental that a claim is provable in bankruptcy only if Congress has so provided." (In re Shawsheen Dairy, 47 F. Supp. 494)

The Bankruptcy Act enumerates a number of provable debts that represent fixed liabilities.[16] These are: (1) a debt evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against the bankrupt, whether then payable or not; (2) a debt due as costs taxable against an involuntary bankrupt who was, at the time of the filing of the petition against him, the plaintiff in an action that would pass to the trustee and that the trustee, upon notice thereof, would refuse to prosecute; (3) a debt founded upon a claim for taxable costs, incurred in good faith by a creditor before the filing of the petition, in an action to recover a provable debt; (4) a debt based upon an open account, or upon a contract expressed or implied; (5) a debt based upon a provable debt reduced to judgment after

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[15] *Ibid.*, §110-(f).
[16] *Ibid.*, §103-(a).

the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs and interest after the filing of the petition; (6) an award of workmen's compensation; (7) a right to damages for negligence; (8) contingent debts and contingent contractual liabilities; and (9) claims for anticipatory breach of contract.

In respect to an unliquidated claim of a creditor, the Bankruptcy Act provides that, upon application to the court of bankruptcy, such a claim shall be liquidated or estimated in such a manner as the court shall direct. If possible to liquidate or estimate the claim within a reasonable time, the claim may be proved and allowed against the estate.[17]

Proof and Allowance of Claims. Proof of claims against the estate of a bankrupt consists of a statement under oath, in writing and signed by the creditor, setting forth the claim, the consideration therefor, and whether, and if so what, securities are held therefor, and that the sum is justly owing from the bankrupt to such creditor. If the claim is based upon a written instrument, such a document, unless lost or destroyed, must accompany the proof of claim. In the event the instrument is lost or destroyed, a statement of such a fact and the surrounding circumstances must be filed under oath with the claim.[18]

> "Where certain creditors are in fact the alter ego of the bankrupt, claims filed by them should be subjected to special scrutiny for the protection of other creditors." (Pomcet Davis Co. v. Roberts, 138 F. [2d] 538)

If a creditor whose claim against the bankrupt is secured by the individual undertaking of any person fails to prove such a claim, such a third person may prove the claim in the creditor's name. If a creditor is a bankrupt and his estate is also being administered in bankruptcy, the trustee may prove the creditor's claim against the estate of the bankrupt debtor in the same manner and upon the same terms as the claims of other creditors.[19]

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[17] *Ibid.*, §§93-(d) and 103-(d).
[18] *Ibid.*, §93-(a)-(b).
[19] *Ibid.*, §93-(i)-(m).

After proving his claim, the creditor may, for purposes of allowance, file his claim in the court where the proceedings are pending or before a referee if the case has been referred to such an officer. Claims that have been duly proved are allowed upon receipt by or upon presentation to the court, unless consideration thereof be continued for cause by the court upon its own motion, or unless an objection is made by parties in interest. Objections to claims are heard and determined at the earliest time that will suit the convenience of the court and the best interests of the estate and of the creditors.[20]

> "The mere filing of a proof of claim is prima facie evidence of its validity, with the burden of disproving it upon the objector." (Sloan's Furriers v. Bradley, 146 F. [2d] 757)

Claims of certain creditors are by the terms of the Bankruptcy Act limited as to allowance.[21] The claims of creditors who are secured or who have priorities are allowable for such sums only as the court determines to be owing over and above the value of such securities or priorities. The claims of a creditor who, within four months prior to the filing of the petition, has received a voidable preference[22] or a void or a voidable conveyance, transfer, assignment, or encumbrance,[23] are not allowable unless the creditor surrenders such preference, conveyance, transfer, assignment, or encumbrance. Debts due to the United States, a state, a county, a district, or a municipality as a penalty or a forfeiture are not allowable except for the amount of the loss suffered from the act or transaction that brought about the penalty or forfeiture, with costs and interest.

Claims of other creditors, by the terms of the Bankruptcy Act, are limited as to proof.[24] Claims against the bankrupt estate may not be proved subsequent to six months after the date set for the first meeting of creditors. In case of a claim by the United States, or any state or subdivision thereof, the

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[20] *Ibid.*, §93-(c)-(d)-(f).
[21] *Ibid.*, §93-(e)-(g)-(j).
[22] *Ibid.*, §96-(b).
[23] *Ibid.*, §107.
[24] *Ibid.*, §93-(n).

court may grant a reasonable extension of time upon cause being shown. Claims of infants and insane persons without guardians, who have no notice of the proceedings, may be proved within one year after adjudication.

Payment of Debts of Bankrupt. Certain debts against the bankrupt estate have priority in payment thereof. The order in which debts are to be paid in full is expressly set forth in the Bankruptcy Act.[25]

Debts to be paid in full in order of priority are: (1) expenses necessary to preserve the estate, filing fees paid by creditors in involuntary proceedings, expenses of creditors in recovering property transferred or concealed by the bankrupt, cost of administration, and the reasonable expenses of creditors in opposing a composition that is refused or set aside; (2) wages due to workmen, clerks, traveling or city salesmen, or servants, earned within three months preceding the petition, not to exceed $600 to each person; (3) expenses of creditors in opposing an arrangement or a plan or the discharge of a bankrupt, or in convicting a person of violating the statute; (4) taxes owed by the bankrupt, except taxes against real estate over and above the value of the interest of the bankrupt therein; and (5) debts owing persons, including corporations, the United States, states, and territories, who by law of the states or the United States are entitled to priority.

> Congress has power under the Constitution to give wage claims priority over taxes in bankruptcy proceedings. (In re Pennsylvania Central Brewing Co., 114 F. [2d] 1010)

The bankrupt may acquire debts during a period when a composition is in force or after a discharge, and the composition is set aside or the discharge is revoked. In such a case, such debts have priority and must be paid in full in advance of the debts provable in the bankruptcy or composition proceedings.[26]

After the foregoing creditors are paid, creditors having allowed claims are paid dividends of an equal per cent on

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[25] *Ibid.*, §104-(a).
[26] *Ibid.*, §104-(b).

After proving his claim, the creditor may, for purposes of allowance, file his claim in the court where the proceedings are pending or before a referee if the case has been referred to such an officer. Claims that have been duly proved are allowed upon receipt by or upon presentation to the court, unless consideration thereof be continued for cause by the court upon its own motion, or unless an objection is made by parties in interest. Objections to claims are heard and determined at the earliest time that will suit the convenience of the court and the best interests of the estate and of the creditors.[20]

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[21] *Ibid.*, §93-(e)-(g)-(j).
[22] *Ibid.*, §96-(b).
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[24] *Ibid.*, §93-(n).

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Debts to be paid in full in order of priority are: (1) expenses necessary to preserve the estate, filing fees paid by creditors in involuntary proceedings, expenses of creditors in recovering property transferred or concealed by the bankrupt, cost of administration, and the reasonable expenses of creditors in opposing a composition that is refused or set aside; (2) wages due to workmen, clerks, traveling or city salesmen, or servants, earned within three months preceding the petition, not to exceed $600 to each person; (3) expenses of creditors in opposing an arrangement or a plan or the discharge of a bankrupt, or in convicting a person of violating the statute; (4) taxes owed by the bankrupt, except taxes against real estate over and above the value of the interest of the bankrupt therein; and (5) debts owing persons, including corporations, the United States, states, and territories, who by law of the states or the United States are entitled to priority.

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After the foregoing creditors are paid, creditors having allowed claims are paid dividends of an equal per cent on

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[25] *Ibid.*, §104-(a).
[26] *Ibid.*, §104-(b).

such claims. The first dividend is ordinarily paid within thirty days after the adjudication, but only if the money of the estate equals five per cent or more than the claims allowed, or that probably will be allowed, after a deduction of the amount necessary to pay the debts that have priority. Subsequent dividends are ordinarily made as often as the distributable money equals ten per cent of the claims, and upon the closing of the estate. Dividends may, however, be oftener and for smaller proportions if the judge shall so order. The Bankruptcy Act sets forth two express restrictions on the payment of dividends, in that the first dividend may not be more than fifty per cent of the claims, and that the last dividend may not be declared within three months after the first dividend is declared.[27]

> The provision of the Bankruptcy Act with reference to the disposal of unclaimed dividends is mandatory "and leaves no discretion with the court." (In re MacMasters, 60 F. Supp. 733)

If a dividend shall remain unclaimed for a period of six months after the final dividend has been declared, the trustee must turn the money over to the court of bankruptcy. Any dividends that are unclaimed for a period of one year are distributed to creditors whose claims have been allowed but not paid in full. After these claims have been paid in full, the remainder, if any, is given to the bankrupt. In this connection, however, it should be noted that in case of dividends belonging to minors, such minors have until one year after attaining majority to claim their dividends.

QUESTIONS

1. Wallis became a bankrupt. The first meeting of his creditors was held at a place designated by the court that was not the county seat of the county in which the bankrupt resided, had his domicile, or had his principal place of business. A creditor contended that the meeting was improperly held. Do you agree?

2. At a meeting of creditors, certain matters that had been presented to them were passed by a majority of one vote. Two of the creditors voting held securities for the amount of their claims. There-

[27] *Ibid.*, §105-(b).

after a creditor contended that the action on the foregoing matters had not been properly taken. Was this contention sound?

3. A petition was filed by creditors to have Dorian declared a bankrupt. Two weeks later it appeared that Dorian was about to leave the district in which he resided for the purpose of avoiding an examination and thus defeating the proceedings in bankruptcy. Were the creditors without a remedy?

4. At a meeting of creditors, the wife of the bankrupt was being examined by order of the court. She was questioned concerning certain personal transactions that she had entered into by using money that she had personally inherited, but she refused to answer. Was she entitled to refuse to answer?

5. A court of bankruptcy ordered certain property of a bankrupt to be sold. The property was sold at a private sale. Thereafter it was contended that the sale of the property had been improperly made. Do you agree with this contention?

6. A trustee sold certain property of a bankrupt free from encumbrances. Notice of the intended sale had been given to all lienholders. Thereafter it was contended that the buyer did not take the property free from liens. Was this contention sound?

7. Certain property of the bankrupt, valued by the appraisers at $1,000, was sold by the trustee for the sum of $600. It was impracticable to obtain the approval of the court for the sale. Thereafter it was contended that the sale was not valid. Do you agree?

8. A creditor obtained a judgment against Whitney for the amount of a debt and court costs. Thereafter Whitney was declared to be a bankrupt. The creditor presented a claim against the estate for the amount of the judgment. It was contended that he was not entitled to prove the claim so far as it consisted of court costs. Do you agree?

9. Craig held a promissory note executed and delivered to him by Ammons, who subsequently became a bankrupt. Craig, in order to prove his claim against the estate of Ammons, presented a statement under oath, signed by him, setting forth the amount of his claim, what he had given for the note, the fact that he had no security, and that the sum was justly owing. It was contended that his claim had not been properly proved. Do you agree?

10. The National Foundry Company became a bankrupt. Brown, who had been employed as a traveling salesman, had earned a salary of $700 during the two months preceding the filing of the petition. Brown contended that he was entitled to priority in the payment of the bankrupt's debts to the extent of $700. Do you agree with this contention?

Part IV—Duties, Rights, and Privileges of Bankrupts

Duties. The successful administration of the estate of a bankrupt depends largely upon the co-operation of such debtor. The Bankruptcy Act therefore sets forth certain things that must be done by the bankrupt.[1]

The bankrupt is required to prepare under oath three statements, all in triplicate, and to file them in court within ten days after filing the petition, if he is a voluntary bankrupt. One statement must contain a schedule of his property, showing the amount and the kind of property, the location thereof, and its money value in detail. A second statement must contain a list of his creditors, showing their residences, if known, the amount due each of them, the consideration thereof, and the security held by each of them, if any. A third statement must contain his claim for the exemptions to which he may be entitled.

> A bankrupt who is not certain whether an interest possessed by him constitutes an asset for creditors should schedule such property and leave the question to the court. (In re Sanders, 20 F. Supp. 98)

The bankrupt is required to attend the hearing for a discharge, and the first and subsequent meetings of his creditors when so ordered by the court. When present at a meeting of creditors, he must submit to an examination concerning the operation of his business, the cause of his bankruptcy, his dealing with his creditors and other persons, the amount, the kind, and the location of his property, and any other matters affecting his estate.

If the bankrupt has property in a foreign country, he must execute a transfer thereof to the trustee. He must also execute and deliver such papers as shall be ordered by the court, and he must comply with all other lawful orders of the court. The bankrupt is required to examine the correctness of all proofs of claims filed against his estate and to report to the trustee the fact that a false claim has been proved when such a fact becomes known to him. He must also report

[1] *United States Code*, Title 11, §25.

immediately to the trustee any attempt by any person to evade the provisions of the bankruptcy legislation.

Rights and Privileges. A bankrupt has the right to appear and oppose an adjudication.[2] He is ordinarily entitled to a trial by jury in respect to the question of solvency when this question is material and in respect to any act of bankruptcy that he is alleged to have committed. If, however, he does not file a written application therefor within the time allowed for an answer to the petition, he is deemed to have waived a trial by jury.[3]

> When the bankrupt in involuntary proceedings denied only two of the allegations of the creditors, "all the other allegations of the petition were admitted to be true." (Sheehan & Egan v. North Eastern Shoe Co., 47 F. [2d] 487)

The bankrupt is exempt from arrest upon civil process, except when the process is issued from a court of bankruptcy for contempt or disobedience of its lawful orders, and when it is issued upon a debt from which his discharge in bankruptcy will not be a release and he is not in attendance in a court of bankruptcy or engaged in the performance of a duty imposed by the Bankruptcy Act.[4] He is also exempt by the express terms of the Bankruptcy Act from any criminal action based upon the testimony given by him at meetings of creditors.[5] Other exemptions of a bankrupt, particularly in respect to his property, vary depending upon the laws of the state wherein he had his domicile for the six months or the greater portion thereof immediately preceding the filing of the petition.[6]

A bankrupt is entitled to offer terms of a composition to his creditors and, when necessary, to request a discharge in bankruptcy. These rights are considered under the following topics.

Discharge of the Bankrupt. The adjudication of any individual to be a bankrupt operates as an application for a

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[2] *Ibid.*, §41-(b).
[3] *Ibid.*, §42.
[4] *Ibid.*, §27.
[5] *Ibid.*, §25-(a).
[6] *Ibid.*, §24.

discharge in bankruptcy. A corporation may file an application for a discharge within six months after it is adjudged to be a bankrupt.[7]

The application for discharge will be denied if the bankrupt has: (1) committed an offense punishable by imprisonment as provided in the act; (2) unjustifiably destroyed, mutilated, falsified, concealed, or failed to keep books of account or records from which his financial status and business transactions might be ascertained; (3) obtained money or property by means of a false representation in writing concerning his financial condition; (4) permitted others, within a year previous to the filing of the petition, to remove, transfer, conceal, or destroy any of his property, with the intent to hinder, delay, or defraud creditors, or has been guilty of this himself; (5) been granted a discharge in bankruptcy within six years; (6) refused, during the proceedings, to answer any material question approved by the court, or to obey any lawful order of the court; or (7) failed to explain satisfactorily the loss of any assets, or the deficiency of his assets to pay his debts.[8]

> "A discharge should not be denied to a bankrupt where he has made a mistake as to the law on a question that itself was the subject of considerable litigation." (In re Cohen, 20 F. Supp. 298)

A discharge in bankruptcy releases the bankrupt from all his provable debts, except certain debts that the Bankruptcy Act expressly declares to be unaffected by a discharge.[9] It does not release the bankrupt from debts that: (1) are due as taxes; (2) are liabilities for (a) obtaining property by false pretenses or false representation, (b) for willful and malicious injuries to the person or the property of another, (c) for alimony for the support of a wife or a child, (d) for seduction of an unmarried female, (e) for breach of promise accompanied by seduction, and (f) for criminal conversation; (3) have not been listed in time by the bankrupt, unless the creditor had notice or actual knowledge of the proceedings;

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[7] *Ibid.*, §32-(a).
[8] *Ibid.*, §32-(c).
[9] *Ibid.*, §35.

(4) were created by the bankrupt's fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary position; (5) are wages due to workmen, clerks, salesmen, or servants, which have been earned within three months preceding the petition; or (6) are due for moneys of an employee received or retained by the bankrupt to secure the faithful performance by such employee of the provisions of the contract of employment.

Compositions. The terms of the 1938 statute provide several plans for debtors that are in the nature of compositions. These plans are known as corporate reorganizations, arrangements, real property arrangements by persons other than corporations, and wage earners' plans.

The provisions for corporate reorganizations [10] permit a corporation, an indenture trustee, or three or more creditors with certain claims amounting in the aggregate to $5,000 or over to file a petition for a reorganization. The petition must show among other things that the corporation is insolvent or is unable to pay its debts as they mature, that relief is necessary under this plan, and the proposed scheme of reorganization. The statute directs the court to confirm a plan of reorganization provided that it is fair, equitable, and feasible, that it has been proposed and accepted in good faith, and that all payments made or promised are approved as reasonable.

> "The provision of Section 126 of the Chandler Act which permits such reorganizations, though the petition is involuntary, is in our opinion a valid application of the bankruptcy powers granted to Congress by the Constitution which in no way contravenes the Fifth Amendment." (Brooklyn Trust Co. v. R. A. Security, Inc., 134 F. [2d] 164)

The provisions for arrangements [11] permit any debtor who could become a bankrupt to file a petition for the acceptance of a plan for the settlement, the satisfaction, or the extension of the time of payment of his unsecured debts. The statute directs the court to confirm the plan if it is satisfied that the plan is fair, equitable, and feasible, that the debtor has done

[10] *Ibid.*, Ch. X, §§501 to 676 inclusive.
[11] *Ibid.*, Ch. XI, §§701 to 799 inclusive.

no act which would bar a discharge in bankruptcy, and that the proposal and the acceptance are made in good faith.

> A proposal by a debtor oil company that its president from his personal funds would pay outstanding percentages, permitting the entire net income from its well to be devoted to payment of creditors, constituted a sufficient plan. (In re Kovell Oil Co., 31 F. Supp. 319)

The provisions for real property arrangements [12] permit any debtor who could become a bankrupt, except a corporation, to file a petition for the acceptance of a plan for the alteration or the modification of the rights of creditors holding debts secured by real property or by a chattel real of which the debtor is the legal or the equitable owner. The statute stipulates that the court shall confirm a plan that is accepted by the creditors in good faith.

The provisions for wage earners' plans [13] permit an individual who is insolvent or is unable to pay his debts as they mature and whose wages or salary plus other income does not exceed $3,600, to file a petition for the acceptance of a composition or an extension of time, or both, in view of future earnings or salary. The statute directs the court to confirm a plan that is proposed and accepted in good faith.

QUESTIONS

1. Jessup was declared to be a bankrupt on April 10. On April 16 he signed three statements, each in triplicate, concerning his property, his creditors, and his claims for exemption, and filed them in the court of bankruptcy. It was contended that he had not properly met the requirements of the bankruptcy law. Do you agree?

2. Merryweather, who was adjudged a bankrupt, owned certain property located in Mexico. He refused to transfer this property to the trustee. Was Merryweather acting within his rights?

3. The estate of Eggers was being administered in a court of bankruptcy. During this time Grabinger sought the arrest of Eggers upon a civil process. Eggers contended that under the terms of the

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[12] *Ibid.*, Ch. XII, §§801 to 926 inclusive.
[13] *Ibid.*, Ch. XIII, §§1001 to 1086 inclusive.

bankruptcy legislation he was exempt from all arrests upon civil processes. Was this contention sound?

4. A bankrupt attended a meeting of his creditors and was examined concerning the operation of his business, the cause of his bankruptcy, and certain business transactions. Thereafter a criminal action was commenced against the bankrupt based upon his testimony at the meeting of creditors. It was contended that the action was improperly brought against the bankrupt. Do you agree?

5. Creditors filed a petition to have Lazenby declared to be a bankrupt. Their action was based upon an act of bankruptcy, one element of which was the insolvency of the debtor. Lazenby immediately denied that he had been insolvent at the time of the alleged act and demanded a trial by jury to determine such a fact. Was he entitled to make this demand?

6. Harkins was forced into bankruptcy by his creditors. Twenty days after the adjudication he filed a petition in the court for a discharge in bankruptcy. It was contended that Harkins need not do this. Was this contention sound?

7. The application of Bevins, a bankrupt, for a discharge in bankruptcy was opposed. At the hearing upon the application, the creditors proved that Bevins had not explained satisfactorily the loss of part of his assets. The judge denied the application of Bevins for a discharge. Bevins contended that the action of the judge was improper. Do you agree?

8. A discharge in bankruptcy was granted to Souris. Thereafter Cowles sought to hold Souris liable for a willful and malicious injury to Cowles's automobile that occurred before the petition in bankruptcy. Souris set up the discharge in bankruptcy as a defense to the claim of Cowles. Was this a valid defense?

9. A petition was filed by creditors against Ennis in a court of bankruptcy. Ennis immediately offered terms of a composition to his creditors. It was contended that the offer was improperly made because Ennis at the time had not been adjudged a bankrupt. Was this contention sound?

10. A debtor who could become a bankrupt filed a petition for an arrangement. The plan was accepted by the creditors. Was the court required by the Bankruptcy Act to confirm the plan?

CASES FOR REVIEW

1. Kate C. Putman, as executrix of the estate of Fred C. Putman, obtained a judgment for $10,000 against the Ocean Shore Railway Company for negligently causing the death of Putman. She and two others filed a petition in bankruptcy against J. A. Folger, who had a statutory liability for the debts of the railway corporation. In opposing the petition, he contended that the claim of Mrs. Putman was not a provable debt in bankruptcy. Do you agree? (In re Putman, 193 F. 464)

2. Bacon was adjudged to be a bankrupt and thereafter requested a discharge in bankruptcy. A creditor objected to the discharge. It was found that Bacon had concealed one hundred shares of stock of the Southern Railway Company, one hundred shares of stock of the United States Steel Corporation, and a check for the sum of $2,503.69 drawn by Haven & Clement upon the Manhattan Company of New York to the order of Bacon. The shares of stock and the check had been received by Bacon just prior to his bankruptcy. Was the request of Bacon for a discharge granted? (In re Bacon, 205 F. 545)

3. Daniel Connelly, within four months prior to the filing of a petition in bankruptcy, transferred a truck to Weissman, his brother-in-law, for the purpose of hindering, delaying, or defrauding his creditors. The trustee in bankruptcy brought an action to compel Weissman to return the truck, or, if the truck had been sold, to pay to the trustee the proceeds of the sale. Was the trustee entitled to judgment? (In re Connelly, 204 F. 479)

4. The Everybody's Grocery & Meat Market, a partnership, was indebted to the Hale-Halsell Grocery Company and other creditors. Certain creditors filed a petition in involuntary bankruptcy, charging that the partnership, while insolvent, had paid the foregoing grocery company the sum of $100 with the intent to give a preference over other creditors, and had transferred its assets to W. F. Vandever, with the intent to hinder, delay, or defraud creditors of the firm. May a partnership be forced into involuntary bankruptcy by the firm creditors? (In re Everybody's Grocery & Meat Market, 173 F. 492)

5. H. O. Michaels was a resident of Marshalltown, Iowa. He was served with a subpoena directing him to appear as a witness in the bankruptcy proceedings of Charles R. Hemstreet before the referee at Emmetsburg, Iowa. He was duly tendered the mileage to Emmetsburg, which was over a hundred miles from Marshalltown, and the fee for one day. Michaels refused, however, to appear as a witness. Was he entitled to do so? (In re Hemstreet, 117 F. 568)

6. Samuel D. Isaacson resided and had a domicile in the borough of Brooklyn, New York, which was in the jurisdiction of a Federal court known as the Eastern District. At the same time he carried on a wholesale business in silks, woolens, and dress goods in the borough of Manhattan, New York, which was in the jurisdiction of a Federal court

known as the Southern District. A number of creditors filed a petition in bankruptcy against Isaacson in the Southern District, and other creditors instituted bankruptcy proceedings against Isaacson in the Eastern District. Could this be done properly under the bankruptcy law? (In re Isaacson, 161 F. 779)

7. Two caretakers, one by day and the other by night, were employed by authority of the bankruptcy court to take care of the bankrupt's property, consisting of a stock of jewelry. Their compensation was fixed at $160 for services covering a period of thirty-two days. The trustees had the sum of $178.51 for distribution among creditors, and therefrom paid the sum of $150 on a debt incurred in recovering property transferred or concealed. The caretakers petitioned the court, contending that their claim had priority of payment over the debt that was paid. Do you agree with the contention? (In re Mitchell, 212 F. 932)

8. A member of the firm of T. A. McIntyre & Company willfully and maliciously injured certain property of Frederick W. Kavanaugh and thereby rendered the other members liable for the wrongful act. Subsequently the firm was adjudged a bankrupt and some of the members were discharged in bankruptcy. These members were sued by Kavanaugh to recover $30,000 in damages. The defendants set up as a defense their discharges in bankruptcy. Did they have a valid defense? (Kavanaugh v. McIntyre, 210 N. Y. 175, 104 N. E. 135)

9. The Aetna Life Insurance Company filed a petition in bankruptcy against the Southwestern Engineering Company. The petition was based upon alleged preferences of the Southwestern Engineering Company by payments, while insolvent, to the Builders' Material Supply Company, a creditor. The B-R Electric & Telephone Manufacturing Company and P. O. Draper, other creditors, filed a petition opposing the petition in bankruptcy. Were they entitled to do so? (B-R Electric & Telephone Mfg. Co. v. Aetna Life Ins. Co., 206 F. 885)

10. W. C. Carpenter, president of a corporation, had a salary of $900 a year. He owned a large majority of the stock and drew more than $2,000 a year from the corporation. In addition, he was in the business of buying and selling real estate. His holdings outside the corporation were worth nearly $90,000. When involuntary proceedings in bankruptcy were instituted by J. N. Judd and other creditors, Carpenter contended that he was exempt from such proceedings by the terms of the Bankruptcy Act. Do you agree? (Carpenter v. Judd, 174 F. 603)

11. The Blue Ridge Packing Company was adjudged to be a bankrupt. At a meeting of the creditors the referee received and rejected certain claims. The Hazel Atlas Glass Company, in making proof of its claim, stated that the consideration was goods and merchandise as evidenced by two notes. The notes were existing, but did not accompany

the statement of claim. If the glass company relied upon the notes for its debt, was its claim properly proved? (In re Blue Ridge Packing Co., 125 F. 619)

12. The Hooks Smelting Company, a corporation, was adjudged to be a bankrupt. At a meeting before a referee, it was alleged that the safe of the corporation contained assets of the bankrupt. William S. Tyron, president, who was being examined, was asked to give to the trustee the combination of the safe for the purpose of ascertaining the truth of the allegation. Tyron refused to do so. Was he justified in so doing? (In re Hooks Smelting Co., 138 F. 954)

13. An involuntary petition in bankruptcy was filed against a merchant doing business at Milwaukee, Wisconsin, in a building leased from Edwin H. Abbot. On the same day, a receiver was appointed, and he took possession of the store and the stock of goods. In an action brought by Abbot upon a claim connected with the possession of the building by the receiver, a question arose as to whether the receiver was vested with title to the bankrupt's assets. What is your opinion? (In re Rubel, 166 F. 131)

14. Certain creditors filed a petition in bankruptcy against the Percy Ford Company. An adjudication of bankruptcy followed. At the time of the filing of the petition, the National Shawmut Bank held four notes upon which the bankrupt was absolutely liable, but the notes were not then due and payable. The bank contended that the notes constituted provable debts. Do you agree with this contention? (In re Percy Ford Co., 199 F. 334)

15. Three creditors filed a petition in bankruptcy against Michael B. Larkin. It was alleged and proved that within four months preceding the filing of the petition Larkin had conveyed and transferred the greater part of his assets without a present consideration to two persons with the intent to hinder, delay, or defraud his creditors. In opposing the petition, it was contended that Larkin had not committed an act of bankruptcy, because he had not been insolvent at the time of the conveyance. Do you agree? (In re Larkin, 168 F. 100)

16. The Morgantown Tin Plate Company was adjudged a bankrupt. An application was made for an order of sale of the bankrupt's property, consisting of a plant at Morgantown, West Virginia. The court ordered the sale and appointed certain commissioners to make the sale. In an action brought by George C. Sturgins to contest the validity of the sale, it was contended that it was necessary for the trustee to make the sale. Do you agree? (Sturgins v. Corbin, 141 F. 1)

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